From MAD to MAR – The New EU Market Abuse Regime

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1. Presentation

2. “EU Market Abuse Regulation – Market Soundings Safe Harbour: Compliance and Record Requirements”

3. “Market Abuse Regulation Requirements for U.S. Issuers”


From MAD to MAR – The New EU Market Abuse Regime

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The EU Regulation on Market Abuse ("MAR") came into effect on 3 July 2016, replacing the previously existing Market Abuse Directive ("MAD").

MAR:

- Expands the application of the EU’s market abuse regime to apply to securities listed on multilateral trading facilities and organised trading facilities in the EU.
- Sets out a number of market abuse offences (including a new “attempted market manipulation” offence) and establishes relevant defences or safe harbours.
- Insider Lists will now require more detailed personal information to be provided.
- Requires issuers and their advisors to keep detailed records of all market soundings and to conduct them in a formalised manner.
- Requires notification of dealings by a person discharging managerial responsibilities ("PDMR") and connected persons once an annual de minimis threshold is reached.
- Expressly prohibits PDMRs within an issuer from dealing in securities in that issuer during a “closed period”.

MAR - Overview
MAR applies to financial instruments:

- admitted to trading, or for which a request for such admission has been made, on a regulated market in an EU Member State;
- traded, admitted to trading, or for which a request for such admission has been made, on a multilateral trading facility (“MTF”);
- traded on an organised traded facility (“OTF”); or
- the price or value of which depends on or has an effect on the price or value of a financial instrument referred to above, including derivative instruments.

MAR also applies to behaviour or transactions relating to emissions allowances, as well as to market manipulation related to spot commodity contracts, commodity derivatives and benchmarks.
• MAR applies to actions and omissions in the EU and in a third country, so an issuer of securities that meet any of the definitions above will be within the scope of MAR whether it is an EU issuer or a non-EU issuer (an “Issuer”).

• Where a non-EU Issuer’s financial instruments are admitted to trading in the EU only on an MTF or an OTF and the issuer has not approved or consented to such admission to trading, the issuer obligations in MAR (i.e. disclosure of inside information, control of inside information and insider lists and dealings by PDMRs) will not apply.

• However, the insider dealing, unlawful disclosure and market manipulation offences will still apply in relation to those instruments.
• Certain monetary and public debt management activities and climate policy activities are not subject to MAR.

• For example, MAR does not apply to transactions, orders or behavior:
  • in pursuit of monetary, exchange rate or public debt management policy by Member States and certain other policy making entities (the European Commission may adopt delegated acts to extend this exemption to certain public bodies and central banks of third countries);
  • in respect of public debt management policy by the European Commission, or any other officially designated body or any persons acting on its behalf; or
  • any special purpose vehicles of one or several EU Member States, certain European bodies and international financial institutions established by two or more Member States which has the purpose of mobilising funding and providing financial assistance to the benefit of its members that are experiencing or threatened by severe financing problems.
Each Member State must designate a single administrative competent authority for the purposes of MAR.

Each competent authority is required to ensure that the provisions of MAR are applied in its territory.

MAR specifies which competent authority is relevant in each circumstance.

For notifications relating to persons discharging managerial responsibilities (or persons closely associated with them) under Article 19 MAR, the competent authority is that of the Member State where the issuer is registered.

If the issuer is not registered in a Member State, such notification shall be made to the competent authority of the “home” Member State (determined by specified criteria) or, in the absence thereof, to the competent authority of the trading venue.
More complex rules apply in relation to notifying a delay in disclosing inside information. Commission Delegated Regulation (EU) 2016/522 provides guidance as to which competent authority the issuer is required to report to in such circumstances:

- The relevant competent authority will be the Member State in which the issuer is registered if (and so long as) the issuer has equity securities or other financial instruments trading, admitted or requested to be admitted on a trading venue in that Member State.

- In other cases (including where the issuer is incorporated in a non-EU jurisdiction), the competent authority will depend on the trading venue of a Member State where it first had equity securities (or, if none, other financial instruments) on a trading venue traded, admitted or requested to be admitted for the first time.

- Where more than one Member State qualifies under the above criteria, the relevant competent authority of an issuer may depend on which is the most “relevant market” in terms of liquidity.
MAR prohibits:

• insider dealing (Article 14(1)(a));
• attempted insider dealing (Article 14(1)(b));
• recommending or inducing another to engage in insider dealing (Article 14(b));
• unlawful disclosure of inside information (Article 14(c));
• market manipulation (Article 15);
• attempted market manipulation (Article 15); and
• dealing by a person discharging managerial responsibilities during a closed period (Article 19(ii)).
Under Article 14 MAR, the following are offences:

- engaging or attempting to engage in insider dealing;
- recommending or inducing another to engage in insider dealing; or
- unlawfully disclosing inside information.

Insider dealing is where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates.

The definition also applies to the use of inside information by cancelling or amending an order concerning a financial instrument to which the information relates, where the order was placed before the person concerned possessed the inside information.
Inside information means information:

- of a precise nature;
- which has not been made public;
- relating, directly or indirectly, to one or more Issuers or to one or more financial instruments; and
- which, if it were made public, would be likely to have a significant effect on the prices of any of those financial instruments or on the price of related derivative financial instruments.

- Although this definition seems to have expanded compared to MAD, the FCA in the UK has indicated that there will not be a significant change in the way it interprets inside information.
- In contrast to the US, there is no requirement that there be a fiduciary or fiduciary-like relationship or a duty of trust or confidence between the source of inside information and the recipient. It is possible that activity that is permissible under US laws relating to insider trading will be prohibited under MAR.
• Information shall be deemed to be “of a precise nature” if it indicates:
  • a set of circumstances which exists or which may reasonably be expected to come into existence; or
  • an event which has occurred or which may reasonably be expected to occur,
    in each case where it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of the financial instrument or the related derivative financial instrument.
• Information “likely to have a significant effect” if it were made public means information a reasonable investor would be likely to use as part of the basis of his or her investment decisions.
Article 9 of MAR provides various examples of behaviour that is considered legitimate behaviour in the context of the insider dealing offences, as well as the market manipulation offences. These include situations where:

- the legal person in possession of inside information has taken steps to ensure that the natural person who made the acquisition or disposal is not in possession of the inside information, and has not influenced that natural person;
- the person in possession of inside information is a market maker acting legitimately in the normal course of the exercise of such function;
- the person in possession of inside information is authorised to execute orders on behalf of third parties and acts legitimately in the normal course of the exercise of that person’s employment, profession or duties;
- the person in possession of inside information acquires or disposes of financial instruments in discharge of a pre-existing obligation that has become due in good faith; and
• the person in possession of inside information obtained such information in the course of conducting a public takeover or merger with a company and uses the information solely for proceeding with that merger or public takeover (and not for stake-building), so long as that information has ceased to be inside information at the time of approval of the merger or acceptance of the offer by the shareholders of that company.
Unlawful Disclosure Offence

• MAR prohibits a person from unlawfully disclosing inside information relating to securities within the scope of the legislation (Article 14(c)).

• An unlawful disclosure is made when a person possesses inside information and discloses it to any other person, except in the normal exercise of their employment, profession or duties.

Market Soundings Safe Harbour

• A disclosure of inside information made in the course of a market sounding is deemed to be made in the normal exercise of a person's employment, profession or duties where the disclosing market participant ("DMP") complies with certain specified conditions.
A market sounding is the communication of information, usually by a dealer or manager on behalf of an Issuer, about a potential new issuance, in order to gauge the interest of potential investors in a potential transaction and related conditions.

DMPs and market sounding recipients (“MSRs”) must comply with a number of conditions whenever conducting a market sounding, whether or not the market sounding involves the disclosure of inside information.

Prior to conducting a market sounding, a DMP must specifically assess whether the market sounding will involve the disclosure of inside information and make a written record of its conclusion and the reasons therefor. This obligation applies to each separate disclosure of information during a market sounding.

Where information that has been disclosed in the course of a market sounding ceases to be inside information according to the assessment of the DMP, the DMP shall inform the MSR accordingly, as soon as possible.

All records must be made available to the competent authority on request.
• If the DMP concludes that the market sounding involves inside information, the communication from the DMP to the MSR must:
  • include a statement that the communication is for the purposes of a market sounding;
  • if the conversation is being recorded, include a statement to that effect and a statement obtaining consent to record the conversation;
  • include confirmation from the MSR individual that they are the person entrusted by the recipient institution to receive the sounding;
  • clarify that if the person agrees to receive the sounding (i) that inside information will be disclosed and (ii) the recipient is obliged to separately consider for itself whether it is inside information;
  • if possible, include an estimation of when the information will cease to be inside information, the factors that might affect that estimation and how the recipient will be informed of any change;
  • inform the recipient of their obligation to keep the information confidential and not to trade (or amend a pre-existing instruction to trade) on the basis of it;
  • obtain the recipient's consent to receiving inside information; and
  • if the MSR consents, identify the information that is inside information.
If the DMP concludes that the market sounding does not involve inside information, the communication from the DMP to the MSR must include:

- a statement that the communication is for the purposes of a market sounding;
- if the conversation is to be recorded, a statement to that effect and obtaining consent to recording the conversation;
- confirmation that the individual is the person entrusted by the recipient institution to receive the sounding;
- a statement that (i) the recipient will receive information which the discloser considers not to be inside information and (ii) reminds the recipient that they are obliged to separately consider for themselves whether it is inside information; and
- the recipient’s consent to receive the market sounding.

The same level of information must be communicated to each recipient of each market sounding.

The DMP must also comply with certain record-keeping requirements, even where it is decided that the market sounding does not contain inside information.
Records of the following must be kept by the DMP for five years:

- the list of all persons receiving information (including contact details), date/time of sounding and any follow-up;
- the list of any potential investors refusing to receive any soundings (who may then not be sounded out;
- the facts relevant to the assessment that any inside information has ceased to be such;
- the discloser's procedures and standard set of information on market soundings;
- all communications with recipients of market soundings including documents provided to them; and
- if conversations are not recorded, then minutes are required, drawn up by discloser in accordance with a European Securities and Markets Authority ("ESMA") template and which include the date/time, identity of parties, information and materials disclosed, and the consents obtained. If minutes are not agreed within five business days after the sounding, then records of both the discloser's and recipient's versions of the minutes must be retained.

ESMA has published guidelines for the recipients of market soundings
MAR requires an Issuer to inform the public as soon as possible of inside information which directly concerns the Issuer (Article 17(1)).

The disclosure needs to be made in a manner which enables “fast access and complete, correct and timely assessment of the information by the public” and on the European Electronic Access Point, when this is established by ESMA.

The Issuer cannot combine the disclosure with the marketing of its activities. All inside information must be posted and maintained on the Issuer’s website for at least 5 years.

An Issuer may generally only delay disclosure if, and for so long as:
- the Issuer’s legitimate interests are likely to be prejudiced by immediate disclosure; and
- the delay of disclosure is not likely to mislead the public; and
- the Issuer is able to ensure the confidentiality of that information.
• If such disclosure is delayed, the Issuer must notify the competent authority that disclosure of the information was delayed, immediately after the information is disclosed. Competent authorities may require a written explanation of how the conditions set out above were met to be given on request, or to be provided with the notification.

• ESMA’s Final Report on MAR (published 13 July 2016) has set out a non-exhaustive, indicative list of situations when it will be in an Issuer’s legitimate interests to delay disclosure, including where:
  • the Issuer is conducting negotiations, the outcome of which would likely be jeopardised by immediate public disclosure of that information;
  • the financial viability of the Issuer is in grave and imminent danger, and immediate public disclosure of the inside information would seriously prejudice the interests of existing and potential shareholders, by jeopardising the conclusion of the negotiations aimed at ensuring the financial recovery of the Issuer;
• the inside information relates to decisions taken or contracts entered into by the management body of an Issuer which need the approval of another body of the Issuer (other than shareholders) in order to become effective and immediate disclosure would jeopardise the correct assessment of the information by the public, provided that the Issuer has arranged for the other body to take its decision as soon as possible;
• the Issuer has developed a product or an invention and the immediate public disclosure of that information is likely to jeopardise the intellectual property rights of the Issuer;
• the Issuer is planning to buy or sell a major holding in another entity and disclosure may jeopardise the deal;
• a UK deal or transaction that has been previously announced is subject to a public authority’s approval and the approval is subject to conditions and disclosure of those conditions is likely to affect the issuer’s ability to meet the conditions.
ESMA’s Final Report on MAR also sets out three (non-exhaustive) examples when the delay in the disclosure is likely to mislead the public and where immediate and appropriate disclosure is always necessary and mandatory:

- the inside information is materially different from a previous public announcement of the Issuer on the matter to which the inside information relates; or
- the inside information relates to the fact that the Issuer’s financial objectives are not likely to be met, where such objectives were previously publicly announced; or
- the inside information contrasts with the market’s expectations, where such expectations are based on signals that the Issuer has previously sent to the market, such as interviews, roadshows or any other type of communication organized by the issuer or with its approval.

In assessing the market’s expectations, the Issuer should take into account the market sentiment, for instance considering the consensus among financial analysts.
In order to preserve the stability of the financial system, an issuer that is a credit or financial institution may delay the public disclosure of inside information (Article 17(5)).

This includes information relating to a temporary liquidity problem and the need to receive temporary liquidity assistance from a central bank or lender of a last resort, if all of the below are satisfied:

- the disclosure of insider information entails a risk of undermining the financial stability of the issuer and of the financial system;
- it is in the public interest to delay the disclosure;
- the confidentiality of that information can be ensured; and
- the relevant competent authority has consented to delay on the basis that the above conditions are met.
• MAR requires that Issuers or persons acting on their behalf shall maintain a list of all persons who have access to inside information and who are working for or under them, or otherwise have access to inside information.

• This list must be kept updated and made available to the competent authority on request.

• These lists must adhere to the prescribed format (see Commission Implementing Regulation (EU) 2016/347).

• Issuers, or any person acting on their behalf or on their account, shall take all reasonable steps to ensure that any person on the insider list:
  • acknowledges in writing the legal and regulatory duties entailed; and
  • is aware of the sanctions applicable to insider dealing and unlawful disclosure of inside information.
• The insider list must include:
  • the identity of any person having access to inside information;
  • the reason for including that person in the insider list;
  • the date and time at which that person obtained access to inside information; and
  • the date on which the insider list was drawn up.

• Issuers, or any person acting on their behalf or on their account, shall retain the insider list for at least five years after it is drawn up or updated.
• Persons discharging managerial responsibilities ("PDMRs"), as well as persons closely associated with them, must notify the Issuer and the competent authority of certain transactions relating to the shares or debt instruments of that Issuer or to derivatives or other financial instruments linked to them.

• The transactions that must be notified include:
  - the pledging or lending of financial instruments by on behalf of a PDMR or a person closely associated with such a person (a pledge or similar security interest does not need to be notified unless such pledge or other security interest is to secure a specific credit facility);
  - transactions undertaken by persons professionally arranging or executing transactions or by another person on behalf of a PDMR or a person closely associated with such a person (including where discretion is exercised); and
  - transactions made under a life insurance policy (as defined in accordance with Directive 2009/138/EC) in certain circumstances.
• A person closely associated with a PDMR includes:
  • a spouse, or a partner considered to be equivalent to a spouse in accordance with national law;
  • a dependent child, in accordance with national law;
  • a relative who has shared the same household for at least one year on the date of the transaction concerned; or
  • a legal person, trust or partnership, the managerial responsibilities of which are discharged by a PDMR or a person referred to above, which is directly or indirectly controlled by a person, which is set up for the benefit of such a person, or the economic interests of which are substantially equivalent to those of such a person.

• Such notification must contain the following information:
  • the name of the person;
  • the reason for the notification;
  • the name of the relevant issuer;
  • a description and the identifier of the financial instrument;
  • the nature of the transaction(s);
  • the date and place of the transaction(s); and
  • the price and volume of the transaction(s).
• The notification must be made to the competent authority within three working days of the transaction date.
• The notification requirement is subject to a de minimis threshold of €5,000 (or a higher threshold, not exceeding €20,000, if set by a Member State).
• PDMRs are also prohibited from trading any securities of the Issuer, or derivatives or other financial instruments linked to them, during a “closed period” (30 calendar days before the announcement of an interim financial report or a year-end report which the Issuer is obliged to make public under either its national laws or the rules of the trading venue where the Issuer’s shares are admitted to trading).
• MAR requires persons who produce or disseminate investment recommendations or other information recommending or suggesting an investment strategy to take reasonable care to:
  • ensure that such information is objectively presented; and
  • to disclose their interests or indicate conflicts of interest concerning the financial instruments to which that information relates.
• An “investment recommendation” means information:
  • recommending or suggesting an investment strategy;
  • explicitly or implicitly concerning one or several financial instruments or the issuers;
  • including any opinion as to the present or future value or price of such instruments;
  • intended for distribution channels or for the public.
In the ESMA Final Report of September 2015, ESMA took the view that:

- “an investment recommendation is intended for distribution channels or for the public ... when it is intended or expected to be distributed to clients or to a specific segment of clients, whatever their number, as a non-personal recommendation... ESMA considers that a too narrow definition of ‘investment recommendation intended for distribution channels or for the public’ would entail the risk of leaving some investment recommendations provided to investors unregulated, without investors being in a position to know that the recommendation received is not regulated.”

- ICMA has interpreted the ESMA report in their Q&A in March 2016 as meaning “...that investment recommendations are in scope of MAR where they are disseminated to more than one client.”

- However, this issue is still being raised with the FCA in the UK who are reviewing it.
The market manipulation offence under MAR catches a number of activities:

- entering into a transaction, placing an order to trade or any other behaviour which:
  - gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument; or
  - secures, or is likely to secure, the price of one or several financial instruments at an abnormal or artificial level,
  unless the relevant person establishes that such transaction, order or behaviour has been carried out for legitimate reasons and conforms with an accepted market practice;

- entering into a transaction, placing an order to trade or any other activity or behaviour which affects or is likely to affect the price of one or several financial instruments which employs a fictitious device or any other form of deception or contrivance;
• disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument or secures, or is likely to secure, the price of one or several financial instruments at an abnormal or artificial level, including the dissemination of rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading; and

• transmitting false or misleading information or providing false or misleading inputs in relation to a benchmark where the person who made the transmission or provided the input knew or ought to have known that it was false or misleading, or any other behaviour which manipulates the calculation of a benchmark.

• MAR provides (in Article 12(2) and Annex 1) a non-exhaustive list of conduct that will be considered as market manipulation and indicators of the employment of a fictitious device or deception, and indicators relating to false/misleading signals and to “price securing.”
A competent authority may establish an accepted market practice ("AMP"). They will need to take into account the following criteria in doing so, as set out in Article 13(2) of MAR:

- whether the market practice provides for a substantial level of transparency to the market;
- whether the market practice ensures a high degree of safeguards to the operation of market forces and the proper interplay of the forces of supply and demand;
- whether the market practice has a positive impact on market liquidity and efficiency;
- whether the market practice takes into account the trading mechanism of the relevant market and enables market participants to react properly and in a timely manner to the new market situation created by that practice;
• whether the market practice does not create risks for the integrity of, directly or indirectly, related markets, whether regulated or not, in the relevant financial instrument within the EU;
• the outcome of any investigation of the relevant market practice by any competent authority or by another authority; and
• the structural characteristics of the relevant market.
• A market practice that has been established by a competent authority as an AMP in a particular market shall not be considered to be applicable to other markets, unless the competent authorities of those other markets have accepted that practice under Article 13 of MAR.
• Currently, no AMPs have been established by any of the FCA in the UK, the CBI in Ireland or the CSSF in Luxembourg.
• However, the European Commission has adopted some criteria (in Commission Delegated Regulation (EU) 2016/908) for individual competent authorities to establish AMPs.
Certain exemptions from the insider dealing and market manipulation offences under MAR are available for share buy-back programmes and stabilisation measures. If the conditions for the relevant exemption are satisfied, then the relevant buy-back or stabilisation measure will fall outside the market abuse prohibitions.

The requirements for the share buy-back exemption are as follows:

- the full details of the programme are disclosed prior to the start of trading;
- trades are reported as being part of the buy-back programme to the competent authority of the trading venue and subsequently disclosed to the public;
- adequate limits with regard to price and volume are complied with;
- it is carried out in accordance with the following sole purpose:
  - to reduce the capital of an issuer;
  - to meet obligations arising from debt financial instruments that are exchangeable into equity instruments; or
• to meet obligations arising from share option programmes, or other allocations of shares, to employees or to members of the administrative, management or supervisory bodies of the issuer or of an associate company; and

• it is carried out in accordance with the relevant provisions of MAR and related regulatory technical standards.

• The issuer must report to the competent authority of the trading venue on which the shares have been admitted to trading or are traded each transaction relating to the buy-back programme.

• The requirements for the stabilisation of securities exemption are as follows:
  • stabilisation is carried out for a limited period;
  • relevant information about the stabilisation is disclosed and notified to the competent authority of the trading venue;
  • adequate limits with regard to price are complied with; and
  • such trading complies with the conditions for stabilisation laid down in the relevant regulatory technical standards.
• Details of the stabilisation must be notified to the competent authority of the trading venue no later than the end of the seventh daily market session following the date of execution of such transactions.

• Entering into buy-backs and stabilisation action in circumstances where the action would not benefit from the exemptions under MAR should, however, not automatically be deemed to constitute market abuse.

• Note that buy-backs of debt securities will not qualify for the specific buy-back exemption (as such exemption applies to shares only).
The EU Directive on Criminal Sanctions for Market Abuse ("CSMAD") requires relevant Member States to transpose its provisions into national law by 3 July 2016.

The UK (and Denmark) opted out of CSMAD and therefore are excepted from such requirement.

However, the scope of CSMAD’s application means that it remains relevant to UK firms operating in other Member States.
Under CSMAD, Member States must ensure that behaviour falling within one or more of the below categories constitutes a criminal offence, at least in “serious cases and when committed intentionally”. The relevant behaviours include:

- insider dealing and/or recommending or inducing another person to engage in insider dealing;
- unlawful disclosure of inside information;
- market manipulation; and
- inciting, aiding and abetting, and attempting to commit, certain of these criminal offences.
• Recital 11 provides that insider dealing and unlawful disclosure of inside information should be deemed to be serious in cases such as those where:
  • the impact on the integrity of the market;
  • the actual or potential profit or loss avoided;
  • the level of damage caused to the market; or
  • the overall value of the financial instruments traded is high.

• Recital 12 provides that market manipulation should be deemed to be serious in cases such as those where:
  • the impact on the integrity of the market;
  • the actual or potential profit derived or loss avoided;
  • the level of damage caused to the market;
  • the level of alteration of the value of the financial instrument; or
  • the amount of funds originally used is high or where the manipulation is committed by a person employed or working in the financial sector or in a supervisory or regulatory authority.
When such offences are committed by a natural person, they should be punishable by criminal penalties that are “effective, proportionate and dissuasive”. CSMAD provides a minimum level for the maximum term of imprisonment of:

- at least four years, for insider dealing offences and market manipulation offences; and
- at least two years, for the unlawful disclosure of inside information offence.

Legal persons can be held liable where the lack of supervision or control by any person who has a “leading position” within the legal person has made possible the commission of a market abuse offence for the benefit of the legal person by a person under its authority.

Sanctions under CSMAD, when offences are committed by legal persons, must include criminal and non-criminal fines. However, other sanctions may include:

- exclusion from entitlement to public benefits or aid;
- permanent or temporary suspension from commercial activities;
- placing under judicial supervision;
- judicial winding-up; and
- permanent or temporary closure of establishments which have been used for committing an offence.
Currently, MAR and CSMAD do not affect the separate UK criminal offences relating to:

- insider dealing by individuals under section 52 of the Criminal Justice Act 1993 ("CJA 1993") (the "CJA Offences"); nor
- the making of misleading statements or impressions under sections 89 to 91 of the Financial Services Act 2012 ("FSA 2012") (the "Misleading Offences").

Such offences have a UK territorial scope and the UK elements required to be satisfied depend on the individual offence.
Where an individual has information as an insider, an individual commits a CJA Offence if:

- he deals in price-affected securities in relation to the information, and the circumstances relate to an acquisition or disposal that occurs on a regulated market (the “Dealing Offence”);
- he encourages another person to deal in price-affected securities (whether or not that other knows it) in relation to the information, knowing or having reasonable cause to believe that the dealing would take place, and the circumstances relate to an acquisition or disposal that occurs on a regulated market, or through a professional intermediary (the “Encouraging Offence”); or
- he discloses the information, otherwise than in the proper performance of the functions of his employment, office or profession, to another person (the “Disclosing Offence”).

The CJA Offences are punishable by fines or imprisonment.

A person convicted of insider dealing may also be disqualified from acting as a director of a company.
Defences to the CJA Offences include:

- In respect of the Dealing Offence and Encouraging Offence, the defendant: (1) did not expect the dealing to result in profit attributable to the fact the information was price-sensitive information, (2) believed on reasonable grounds that the information had been disclosed widely enough to ensure that others dealing would have not been prejudiced by not having the information or (3) would have done what he did even if he had not had the information.

- In respect of the Disclosing Offence, the defendant did not expect the disclosure to result in any person dealing on a regulated market or in reliance on a professional intermediary or did not expect such dealing to result in profit attributable to the fact that information was price sensitive.
• There are also specific “special” defences applying only to the Dealing Offence and the Encouraging Offence. These are:

• For market makers, an “acting in good faith” defence.

• If participants in the market acquire “market information” in the course of that participation, the inside information was market information and it was reasonable for the relevant person to have acted as he did despite having the information as an insider.

• Where a person acts in conformity with certain rules, such as buyback and stabilisation rules.
• The Misleading Offences are:

• A person (knowingly or recklessly) makes a statement that is false or misleading in a material respect, or dishonestly conceals any material facts if done (intentionally or recklessly) to induce another person to: (1) enter or offer to enter into, or to refrain from entering or offering to enter into, a relevant agreement or (2) exercise, or refrain from exercising any rights conferred by a relevant investment (the “Section 89 Offence”).

• A person (knowingly or recklessly) does any act or engages in any course of conduct which creates a false or misleading impression as to the market in, or the price or value of, any relevant investment (a) with the intention of inducing another person to acquire, dispose of, subscribe for or underwrite the investments or to refrain from doing so and/or (b) intends to produce certain gain-making, loss-making or risk-increasing results/effects (the “Section 90 Offence”).
• A person (knowingly or recklessly) makes a false or misleading statement to another person in the course of arrangements for the setting of a relevant benchmark and intends the recipient to use the statement for the setting of a relevant benchmark.

• A person (knowingly or recklessly) does any act or engages in any course of conduct which creates a false or misleading impression as to the price or value of any investment as to the interest rate appropriate to any transaction if (a) the person intends to create that impression, and (b) the impression may affect the setting of a relevant benchmark (together with the previous bullet point, the “Section 91 Offences”).

• The Misleading Offences are punishable by fines or imprisonment.

• The UK Financial Conduct Authority has the power to prosecute the Misleading Offences, however, up to date, it has not yet done so.
Defences to the Misleading Offences include:

- For the Section 89 Offence, the statement was made in conformity with either the price stabilising rules or control of information rules or the relevant exemptions of buy back and stabilisation regimes for financial instruments.
- For the Section 90 Offence any of: (1) the relevant person reasonably believed his conduct would not create an impression that was false or misleading, (2) the relevant person acted or engaged in the conduct for the purpose of stabilising the price of investments and in conformity with price stabilising rules, (3) the relevant person acted or engaged in the conduct in conformity with control of information rule or (4) the relevant person acted or engaged in the conduct in conformity with relevant exemptions of buy back and stabilisation regimes for financial instruments.
- For the Section 91 Offences, the statement/conduct engaged in, conformed with price stabilising rules, control of information rules or relevant rules on exemptions for buy back and stabilisation regimes for financial instruments.

In the Bank of England’s Fair and Effective Market Review, it recommended widening the scope of criminal sanctions for the UK market abuse regime for individuals and firms to a wider range of fixed income, currency and commodities instruments.
• Depending on the post-Brexit relationship between the UK and the EU, MAR may cease to apply in the UK following Brexit.
• In these circumstances, the UK would need to decide whether, and to what extent, to replicate MAR in the UK.
• MAR would still apply to UK Issuers with financial instruments traded (or which have applied to trade) on a regulated market, MTF, or OTF in the EU, or the price or value of which depends on or has an effect on the price of such a financial instrument.
• MAR might not apply to EU Issuers with financial instruments in the UK although:
  • this depends on the future relationship between the UK and the EU; and
  • UK may replicate MAR in any event.
• In order for UK-based financial institutions to be able to have access to the single market, it is likely the EU will require the UK to maintain a market abuse regime which is compatible with the requirements of MAR.
• Companies should review procedures, systems and controls relating to:
  • Insider Lists
  • Identifying inside information and ensuring prompt disclosure
  • Understanding when disclosures may be delayed and the information that will need to be provided to the competent authority relating to the delayed disclosure
  • Market Soundings Scripts and Procedures (particularly the requirements for non-recorded meetings)
  • PDMR dealings, permissions and record-keeping
  • “Own dealings” (e.g. buy-backs) that might be regarded as market abuse by the Issuer
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**Background: The Prohibition**

The EU Regulation on Market Abuse ("MAR") prohibits a person from unlawfully disclosing inside information relating to securities within the scope of the legislation. An unlawful disclosure is made when a person possesses inside information and discloses it to any other person, except in the normal exercise of their employment, profession or duties.

MAR applies to financial instruments:

1. traded (or which have applied to trade) on a regulated market in an EU Member State;
2. traded (or which have applied to trade) on a multilateral trading facility ("MTF");
3. traded on an organised trading facility ("OTF"); or
4. the price or value of which depends on or has an effect on the price of a financial instrument referred to in (a), (b) or (c), including derivative instruments.

The legislation applies to actions and omissions in the EU and in a third country, so a U.S. bank performing market soundings on behalf of an issuer subject to MAR will need to comply and be aware of the requirements summarised in this note.

**Inside Information**

Inside information means information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the price of any of those financial instruments or on the price of related derivative financial instruments.

Information shall be deemed to be “of a precise nature” if it indicates:

- a set of circumstances which exists or which may reasonably be expected to come into existence, or
- an event which has occurred or which may reasonably be expected to occur,

where it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of the financial instrument or the related derivative financial instrument.

Information “likely to have a significant effect” if it were made public means information a reasonable investor would be likely to use as part of the basis of his or her investment decisions.

**Market Soundings Safe Harbour**

A disclosure of inside information made in the course of a market sounding is deemed to be made in the normal exercise of a person’s employment, profession or duties where the disclosing market participant (“DMP”) complies with certain specified conditions. DMPs and market sounding recipients (“MSRs”) must comply with certain conditions whether or not the market sounding involves the disclosure of inside information.

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1 For the purposes of MAR, the definition of “financial instruments” is found in Section C, Annex I to Directive 2014/65/EU ("MiFID II"). This is wide enough to cover debt securities.

2 MAR Article 2(1). Note that the action/behaviour itself does not have to occur on a trading venue (see Article 2(3) MAR).
Compliance

Prior to conducting a market sounding, a DMP must specifically assess whether the market sounding will involve the disclosure of inside information.

If the market sounding involves inside information, the communication from the DMP to the MSR must include:

- a statement that the communication is for the purposes of a market sounding;
- if on a recorded telephone line, a statement that the conversation is being recorded and obtaining consent to recording the conversation;
- confirmation that the MSR individual is the person entrusted by the recipient institution to receive the sounding;
- clarifying that if the person agrees to receive the sounding (i) that inside information will be disclosed and (ii) the recipient is obliged separately consider for itself whether it is inside information;
- if possible, an estimation of when the information will cease to be inside information, the factors that might affect that estimation and how the recipient will be informed of any change;
- informing the recipient of his obligation to keep the information confidential and not to trade (or amend a pre-existing instruction to trade) on the basis of it;
- obtaining the recipient’s consent to receiving inside information; and
- if the MSR consents, identifying the information that is inside information.

Even if the market sounding does not involve inside information, the communication from the DMP to the MSR must include:

- a statement that the communication is for the purposes of a market sounding;
- if on a recorded telephone line, a statement that the conversation is being recorded and obtaining consent to recording the conversation;
- confirmation that the individual is the person entrusted by the recipient institution to receive the sounding;
- a statement that (i) the recipient will receive information which the discloser considers not to be inside information and (ii) reminds the recipient that they are obliged to separately consider for themselves whether it is inside information; and
- the recipient agreeing to receive the market sounding.

The same level of information must be communicated to each recipient of each market sounding.

Recordkeeping Requirements

The DMP must also comply with certain recordkeeping requirements, even where it is decided that the market sounding does not contain inside information.

Records of the following must be kept for five years:
- the list of all persons receiving information (including contact details), date/time of sounding and any follow-up;
- the list of any potential investors refusing to receive any soundings;
- the obligation to refrain from sounding out these investors;
- the facts relevant to the assessment that any inside information has ceased to be such;
- the discloser’s written procedures on market soundings;
- all communications with recipients of market soundings including documents provided to them (i.e., copies of written correspondence, audio/video recordings or minutes); and
• if conversations are not recorded, then minutes are required, drawn up by discloser in accordance with a European Securities and Markets Authority template and which include the date/time, identity of parties, information and materials disclosed, and the consents obtained. If minutes are not agreed within five business days after the sounding, then records of both the discloser’s and recipient’s versions of the minutes must be retained.

All records must be made available to the competent authority on request.

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Background

The EU Regulation on Market Abuse ("MAR") came into effect on 3 July 2016, replacing the previously existing Market Abuse Directive and expanding the application of the EU’s market abuse regime. In addition to detailing various offences, MAR imposes a number of requirements for information disclosure, insider lists and dealings by senior managers of issuers. For U.S. and other non-EU issuers of securities, MAR brings about a key change by expanding the scope of the market abuse regime to apply to securities listed on multilateral trading facilities and other trading venues in the EU (e.g., Luxembourg’s Euro MTF and Ireland’s Global Exchange Market).

This guidance note summarises some key requirements that U.S. and other non-EU securities issuers should be aware of, but it is intended only as a high-level overview of the MAR regime and we recommend that you consult suitably qualified legal counsel where you consider that MAR may be relevant to your situation.

Scope of MAR

MAR applies to financial instruments:

1. admitted to trading or for which a request for such admission has been made, on a regulated market in an EU Member State;
2. traded, admitted to trading or for which a request for such admission has been made, on a multilateral trading facility ("MTF");
3. traded on an organised traded facility ("OTF");
4. the price or value of which depends on or has an effect on the price of a financial instrument referred to in (a), (b) or (c), including derivative instruments.

Note that such instruments will only be captured by MAR from the date on which the MiFID II legislative package takes effect, currently scheduled to be 3 January 2018.

MAR also applies to behaviour or transactions relating to emissions allowances, as well as to market manipulation related to spot commodity contracts, commodity derivatives and benchmarks. However, these topics are outside the scope of this guidance note.

MAR applies to actions and omissions in the EU and in a third country, so an issuer of securities that meet any of the definitions above, whether an EU issuer or a non-EU issuer (an “Issuer”), will be within the scope of MAR. Note that MAR applies to any transaction, order or behaviour referred to in the following section, whether or not such transaction, order or behaviour takes place on a trading venue.

The MAR Offences and Accepted Market Practices

MAR prohibits:

(a) insider dealing (Article 14(1)(a));
(b) attempted insider dealing (Article 14(1)(b));
(c) recommending or inducing another to engage in insider dealing (Article 14(b));

1 For the purposes of MAR, the definition of “financial instruments” is found in Section C, Annex I to Directive 2014/65/EU ("MiFID II"). This is wide enough to cover most securities.

2 Note that such instruments will only be captured by MAR from the date on which the MiFID II legislative package takes effect, currently scheduled to be 3 January 2018.
(d) unlawful disclosure of inside information (Article 14(c));
(e) market manipulation (Article 15);
(f) attempted market manipulation (Article 15); and
(g) dealing by a person discharging managerial responsibilities during a closed period (Article 19(ii)).

1. **Insider dealing offences**

Engaging in insider dealing, attempting insider dealing or recommending or inducing another to engage in insider dealing are offences under Article 14 MAR.

Insider dealing is where a person possesses inside information and uses that information by acquiring or disposing of, for its own account or for the account of a third party, directly or indirectly, financial instruments to which that information relates.

The definition also applies to the use of inside information by cancelling or amending an order concerning a financial instrument to which the information relates, where the order was placed before the person concerned possessed the inside information.

**Inside Information**

Inside information means information:

- of a precise nature;
- which has not been made public;
- relating, directly or indirectly, to one or more Issuers or to one or more financial instruments; and
- which, if it were made public, would be likely to have a significant effect on the prices of any of those financial instruments or on the price of related derivative financial instruments.

Information shall be deemed to be “of a precise nature” if it indicates:

- a set of circumstances which exists or which may reasonably be expected to come into existence, or
- an event which has occurred or which may reasonably be expected to occur,

in each case where it is specific enough to enable a conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of the financial instrument or the related derivative financial instrument.

Information “likely to have a significant effect” if it were made public means information a reasonable investor would be likely to use as part of the basis of his or her investment decisions.

Article 9 of MAR provides for various examples of behaviour that is considered legitimate behaviour in the context of the insider dealing offences, as well as the market manipulation offences. These include situations where:

- the legal person in possession of inside information has taken steps to ensure that the natural person who made the decision to acquire or dispose of the relevant financial instrument is not in possession of the inside information;
- the person in possession of inside information is a market maker acting legitimately in the normal course of the exercise of such function;
- the person in possession of inside information is authorised to execute orders on behalf of third parties and acts legitimately in the normal course of the exercise of that person’s employment, profession or duties;
• the person in possession of inside information acquires or disposes of financial instruments in discharge of a pre-existing obligation that has become due, in good faith; and
• the person in possession of inside information obtained such information in the course of conducting a public takeover or merger with a company and uses the information solely for proceeding with that merger or public takeover (and not for stake-building), so long as that information has ceased to be inside information at the time of approval of the merger or acceptance of the offer by the shareholders of that company.

2. Unlawful disclosure of inside information

Under Article 10 MAR, unlawful disclosure of inside information arises where a person possesses inside information and discloses that information to any other person, except where the disclosure is made in the normal exercise of an employment, a profession or duties.

Market soundings

A disclosure of inside information made in the course of a market sounding is deemed to be made in the normal exercise of a person’s employment, profession or duties where the disclosing market participant complies with certain specified conditions. A market sounding is the communication of information, usually by a dealer or manager on behalf of an Issuer, about a potential new issuance, in order to gauge the interest of potential investors of a potential transaction and related conditions. Certain detailed requirements have to be satisfied by the disclosing party, which are discussed in further detail in the guidance note “Market Soundings Safe Harbour: Compliance and Record Requirements.”

3. Required disclosure of inside information

MAR requires an Issuer to inform the public as soon as possible of inside information which directly concerns the Issuer. The disclosure needs to be made in a manner which enables “fast access and complete, correct and timely assessment of the information by the public” and on the European Electronic Access Point, when this is established by the European Securities and Markets Authority. The Issuer cannot combine the disclosure with the marketing of its activities. All inside information must be posted and maintained on the Issuer’s website for at least five years.

An Issuer may only delay disclosure if, and for so long as:

• the Issuer’s legitimate interests are likely to be prejudiced by immediate disclosure;\(^3\) and
• the delay of disclosure is not likely to mislead the public; and
• the Issuer is able to ensure the confidentiality of that information.

If such disclosure is delayed, the Issuer must notify the competent authority that disclosure of the information was delayed, immediately after the information is disclosed. Competent authorities may require a written explanation of how the conditions set out above were met to be given on request, or to be provided with the notification.

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\(^3\) Guidance on when it will be in an Issuer’s legitimate interests to delay disclosure is set out in the ESMA guidelines on MAR (https://www.esma.europa.eu/sites/default/files/library/2016-1130_final_report_on_mar_guidelines.pdf).
4. **Creation and maintenance of insider lists**

MAR requires that Issuers or persons acting on their behalf shall maintain a list of all persons who have access to inside information and who are working for or under them, or otherwise have access to inside information. This list must be kept updated and made available to the competent authority on request.

These lists must adhere to the prescribed format.4

5. **Dealings by PDMRs**

Persons discharging managerial responsibilities (“PDMRs”), as well as persons closely associated with them, must notify the Issuer and the competent authority of certain transactions5 relating to the shares or debt instruments of that Issuer or to derivatives or other financial instruments linked to them. Such notification must contain certain information6 and must be made to the competent authority within three working days of the transaction date.

The notification requirement is subject to a *de minimis* threshold of €5,000 (or a higher threshold, not exceeding €20,000, set by a Member State).

PDMRs are also prohibited from trading any securities of the Issuer, or derivatives or other financial instruments linked to them, during a closed period of 30 calendar days before the announcement of an interim financial report or a year-end report which the Issuer is obliged to make public under either its national laws or the rules of the trading venue where the Issuer’s shares are admitted to trading.

6. **Market manipulation offences**

The following is a list of activities which would fall within the market manipulation offence:

(a) entering into a transaction, placing an order to trade or any other behaviour which:

(i) gives, or is likely to give, false or misleading signals as to the supply of, demand for or price of a financial instrument; or

(ii) secures, or is likely to secure, the price of one or several financial instruments at an abnormal or artificial level,

unless the relevant person establishes that such transaction, order or behaviour has been carried out for legitimate reasons and conforms with an accepted market practice (see “Legitimate reasons and accepted market practice” below);

(b) entering into a transaction, placing an order to trade or any other activity or behaviour which affects or is likely to affect the price of one or several financial instruments which employs a fictitious device or any other form of deception or contrivance;

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5 These are detailed in MAR Article 19(1) and (7) and include selling, purchasing, pledging, and lending and can also include some transactions undertaken on behalf of PDMRs, even where discretion is exercised.
6 Listed in MAR Article 19(6).
(c) disseminating information through the media, including the Internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for or price of a financial instrument or secures, or is likely to secure, the price of one or several financial instruments at an abnormal or artificial level, including the dissemination of rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading; and

(d) transmitting false or misleading information or providing false or misleading inputs in relation to a benchmark where the person who made the transmission or provided the input knew or ought to have known that it was false or misleading, or any other behaviour which manipulates the calculation of a benchmark.

**Legitimate reasons and accepted market practice**

Under Article 13 MAR, the actions specified in paragraph (a) of the foregoing section will not constitute market manipulation (or attempted market manipulation) under Article 15 MAR where they conform with an “accepted market practice” and have been carried out for “legitimate reasons.”

**Accepted market practice**

A competent authority may establish an accepted market practice (“AMP,” or in plural “AMPs”). They will need to take into account the following criteria in doing so, as set out in Article 13(2) of MAR:

- (a) whether the market practice provides for a substantial level of transparency to the market;
- (b) whether the market practice ensures a high degree of safeguards to the operation of market forces and the proper interplay of the forces of supply and demand;
- (c) whether the market practice has a positive impact on market liquidity and efficiency;
- (d) whether the market practice takes into account the trading mechanism of the relevant market and enables market participants to react properly and in a timely manner to the new market situation created by that practice;
- (e) whether the market practice does not create risks for the integrity of, directly or indirectly, related markets, whether regulated or not, in the relevant financial instrument within the EU;
- (f) the outcome of any investigation of the relevant market practice by any competent authority or by another authority; and
- (g) the structural characteristics of the relevant market.

Note that a market practice that has been established by a competent authority as an AMP in a particular market shall not be considered to be applicable to other markets, unless the competent authorities of those other markets have accepted that practice under Article 13 MAR.

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7 Note that under MAR Recital 42, an infringement could still be deemed to have occurred if the relevant competent authority determines that there was an illegitimate reason behind the relevant action.
At the time of writing this guidance note, no AMPs had been established by any of the FCA in the UK, the CBI in Ireland or the CSSF in Luxembourg.

However, the European Commission has adopted some criteria (in Commission Delegated Regulation (EU) 2016/908) for individual competent authorities to establish AMPs. Please see the below extract from Article 3 for more information:

“1. In determining whether a market practice can be established as an AMP and whether it fulfils the criterion set out in point (a) of Article 13(2) of Regulation (EU) No 596/2014, competent authorities shall examine whether the market practice ensures that the following information will be disclosed to the public:

(a) Before a market practice is performed as an AMP:
   (i) the identities of the beneficiaries and the persons who will perform it and the one among them that is responsible for fulfilling the transparency requirements under points (b) and (c) of this paragraph;
   (ii) the identification of the financial instruments in relation to which the AMP will apply;
   (iii) the period during which the AMP will be performed and situations or conditions leading to the temporary interruption, suspension or termination of its performance;
   (iv) the identification of the trading venues on which the AMP will be carried out, and, where applicable, indication of the possibility to execute transactions outside a trading venue;
   (v) reference to the maximum amounts of cash and of the number of financial instruments allocated to the performance of the AMP, if applicable.

(b) Once the market practice is performed as an AMP:
   (i) on a periodic basis, details of the trading activity relating to the performance of the AMP such as the number of transactions executed, volume traded, average size of the transactions and average spreads quoted, prices of executed transactions;
   (ii) any changes to previously disclosed information on the AMP, including changes relating to available resources in terms of cash and financial instruments, changes to the identity of persons performing the AMP, and any change in the allocation of cash or financial instruments in the accounts of the beneficiary and the persons performing the AMP.

(c) When the market practice ceases to be performed as an AMP on the initiative of the person who has been performing it, of the beneficiary or of both:
   (i) the fact that the performance of the AMP has ceased;
   (ii) a description of how the AMP has been performed;
   (iii) the reasons or causes for ceasing the performance of the AMP.

For the purposes of point (b)(i), where multiple transactions in a single trading session are performed, daily aggregated figures may be acceptable in relation to the appropriate categories of information.

2. In determining whether a market practice can be established as an AMP and whether it fulfils the criterion set out in point (a) of Article 13(2) of Regulation (EU) No 596/2014, competent authorities shall examine whether the market practice ensures that the following information will be disclosed to them:

(a) Before a market practice is performed as an AMP, the arrangements or contracts between the identified beneficiaries and the persons who will perform the market practice once established as an AMP where such arrangements or contracts are needed for its performance;
(b) Once the market practice is performed as an AMP, periodic report to the competent authority providing details about the transactions executed and about the operations of any arrangement or contract between the beneficiary and the persons performing the AMP.”

**Overview of U.S. Issuer Actions**

An Issuer with a class of debt securities which are subject to MAR should assess what actions need to be taken immediately to ensure that it is in compliance. These actions may include:

- training for key personnel on the regime and its implications;
- creating policies or procedures on the disclosure of inside information;
- instituting a log for inside information and for recording delayed disclosures (and the follow up notifications);
- creating and maintaining insider lists;
- preparing a list of PDMRs (later defined) and closely associated persons; and
- establishing policies for PDMRs providing notification to regulators.

Additionally, an Issuer will need to consider the effect of MAR if the Issuer intends to redeem a class of in-scope securities (or a portion of a class) or engage in a repurchase of some or all of its securities in open market transactions.

**Buy-backs of Securities**

An Issuer intending to conduct a buy-back of some or all of its in-scope securities needs to bear in mind that there may be a risk of the buy-back constituting insider dealing or market manipulation (as outlined above).

MAR provides an express exemption from those offences for any share buy-back program that meets the specific requirements set out in Article 5 of MAR. However, there is no express exemption provided for buy-backs of debt securities.

Therefore, whether the proposed buy-back of debt securities is intended to be conducted by way of open market transactions or by individual negotiations, and whether by way of a programme or an opportunistic transaction, the Issuer will need to consider the exemptions generally available from the insider dealing and market manipulation prohibitions.

In terms of insider dealing, there can be no insider dealing if there is no unpublished inside information. Therefore, the Issuer must consider whether it is in possession of inside information, as defined earlier. However, it is likely to be only in rare instances that information would constitute inside information in relation to debt securities, as compared to equity securities. However, if those rare circumstances exist, an Issuer should generally consider delaying any buy-back until after the inside information has been made public, or otherwise has ceased to be inside information.

In terms of possible market manipulation, the Issuer will need to be as certain as possible that the buy-back is carried out for legitimate reasons and in accordance with an accepted market practice, as outlined above. In the absence of an Accepted Market Practice established by the competent authority for the relevant jurisdiction of listing/trading, it would be prudent to follow as closely as possible the principles outlined above by the European Commission for the establishment of Accepted Market Practices by EU competent authorities.
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The Big Picture: EU's Financial Regulation Offensive

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In the aftermath of the financial crisis, the national and international response by legislators and regulators has been to substantially overhaul and increase financial regulation applicable to banks and other financial institutions. The primary objectives behind these reforms were to restore financial stability and confidence to the international financial markets and to put in place a regulatory framework to minimize the risks of failures of major financial institutions. In addition, in circumstances where an institution does fail, the aim is to minimize systemic consequences for the wider financial market and avoid the need to use public funds to bail out or support failing institutions.

Much of the regulatory response to the financial crisis has been coordinated at an international level through the G-20 group of countries, which has worked closely with global bodies responsible for setting international standards for financial oversight and regulation, including the Financial Stability Board (FSB), the Basel Committee on Banking Supervision (BCBS) and the International Organisation of Securities Commissions (IOSCO). The international standards arising from these bodies must be implemented separately by national legislators, giving rise to differences in interpretation and implementation in different jurisdictions. The approach of the European Union to financial regulation has to be viewed in the context of these international standards.

The extent and scope of the new regulation that has come into force as a result of these initiatives should not be underestimated. Almost every facet of financial activity and services has been affected directly or indirectly by the new regulatory framework. New regulations have focused on identifying and ameliorating the buildup of risk in the financial system and have included individual requirements on banks and financial institutions to hold greater capital and to comply with liquidity and leverage ratios. Other measures have sought to improve corporate governance and investor protection in relation to financial products.

We consider below some of the principal areas of international regulatory reform and relevant implementation by the EU:

Bank capital, liquidity and leverage: Work has been coordinated by the BCBS through the introduction of the Basel III framework, which maintains banks’ overall minimum capital requirements at 8 percent of risk-weighted assets (RWAs) but has increased the Tier 1 requirement to 6 percent of RWAs. In addition, it has introduced a capital conservation buffer of 2.5 percent of RWAs and a countercyclical buffer (to be imposed at the discretion of national regulators) of up to 2.5 percent of RWAs, each to be comprised of common equity. Basel III also requires banks to comply with (1) a liquidity coverage ratio (LCR) requiring...
the holding of sufficient high-quality liquid assets to cover total net cash outflows over 30 days, (2) a net stable funding ratio (NSFR) aimed at supporting a one-year period of extended stress and (3) a leverage ratio requiring banks to maintain Tier 1 capital of at least 3 percent of average total consolidated assets. In the EU, these requirements have been implemented under a revamped Capital Requirements Directive and a Capital Requirements Regulation (together referred to as “CRDIV”). Under CRDIV, the new Basel III minimum capital rules are in effect and the capital conservation buffer will be fully implemented by 2019. The leverage ratio is intended to be in effect by 2018 and the LCR and NSFR should be fully phased in by 2019.

**Shadow Banking:** Concerns about the systemic risks caused by nonbanks carrying out banking-type activity led to the G-20 mandating the FSB to develop oversight and regulation of shadow banking. In response, the FSB has first developed a monitoring framework to track shadow banking activities and identify systemic risks. Second, it has developed five work streams to strengthen the oversight and regulation of shadow banking including the interaction of the regular banking system with shadow banking, securitization and excess leverage, regulation of securities lending and repos and reform of money market funds. In the EU, many of these work streams have already been fully or partly covered by new legislation, including CRDIV. More recently, the Securities Financing Transactions Regulation came into force in January 2016, introducing reporting requirements for securities financing transactions and imposing limitations on the reuse of collateral. A draft EU regulation in relation to money market funds has made slow progress and is still going through the legislative process.

**Derivatives Regulation:** To seek to address concerns as to the lack of transparency of firms’ exposures and risk-mitigation measures under financial derivatives, the G-20 mandated reporting of all over-the-counter derivatives transactions to trade repositories, clearing of all standardized OTC derivatives through central counterparties and execution of all standardized OTC derivatives on exchanges or electronic trading platforms, where appropriate. In the EU, provisions implementing most of these requirements are included in the European Market Infrastructure Regulation (EMIR), which also contains additional provisions relating to risk-mitigation measures for noncleared derivatives. EMIR came into force in August 2012 and its reporting requirements were phased in from early 2014. The first mandatory clearing obligation (for certain interest rate derivative transactions) applied from June 2016 and further classes of derivatives, such as credit derivatives, will be subject to this obligation shortly. Mandatory exchange trading of derivatives is dealt with by the Markets in Financial Instruments Regulation (MiFIR) which will now not come into effect until the start of 2018.

**Investor Protection and Corporate Governance:** Both the BCBS and G-20 have published principles relating to corporate governance. In the EU, the revamped Markets in Financial Instruments Directive (MiFID II) and MiFIR will, from 2018, impose further requirements relating to product governance in relation to financial instruments and organizational and governance requirements for firms engaging in EU financial services or activities. In addition, the Regulation on Key Information Documents (KIDs) for Packaged Retail and Insurance-based Investment Products (PRIIPS) provides requirements for a short-form KID to be produced for packaged or insurance-based products sold to retail investors with effect from the end of 2016.

**Bank Structural Reform and Recovery and Resolution:** Significant work has been done to seek to ensure that banks and regulators put in place robust and comprehensive recovery and resolution plans. The FSB published its Key Attributes for Effective Resolution Regimes for Financial Institutions in 2011 (updated in October 2014), which form the basis for many of the provisions of the EU Bank Recovery and Resolution Directive (BRRD). The BRRD is now in force and fully implemented within the EU and provides resolution authorities with the power to “bail in” — i.e., impose a write-down or conversion into equity...
— of many unsecured liabilities of the institution. Each member state must also set, for all EU banks, a minimum requirement for eligible (loss-absorbing) liabilities (MREL) expressed as a percentage of an institution’s own funds and total liabilities. Despite the introduction of a draft regulation in January 2014, which sought to limit proprietary trading activities of larger banks, the EU has not yet agreed on a uniform approach to bank structural reform, although some jurisdictions have introduced their own rules, including the U.K., which has introduced legislation requiring the ring-fencing of retail banking from other activities with effect from 2019.

**G-SIB Regulation:** The FSB, together with the BCBS, has developed additional capital, stress-testing and other requirements for global systemically important banks (G-SIBs). The FSB maintains a list of G-SIBs, which it updates on an annual basis. There are currently 30 G-SIBs, including 13 within the EU. Rules developed by the BCBS and the FSB subject G-SIBs to a capital surcharge of between 1 percent and 4.5 percent to be set by national regulators. In December 2015, the FSB finalized proposals for minimum levels of total loss-absorbing capital (TLAC) (comprising Tier 1 and Tier 2 regulatory capital and other eligible loss-absorbing instruments) and leverage ratios to be maintained by G-SIBs, which will be phased-in from 2019. TLAC will be imposed on G-SIBs within the EU by relevant national authorities. Under the BRRD, G-SIBs in the EU must also comply with their MREL requirements (there is significant overlap between TLAC and MREL, although the liabilities eligible for TLAC are narrower than those under MREL).

The EU response to financial regulation has therefore been comprehensive and has largely implemented the various requirements mandated by the relevant international bodies referred to above. Consequently, the principal focus on financial regulation in the EU is now moving away from the introduction of new regulation and toward effective implementation of the new rules and consideration of the effect of those rules on financial institutions and the wider economy.

In September 2015, the EU Commission launched a public consultation in the form of a call for evidence relating to the EU regulatory framework for financial services. It stated that in view of the huge amount of financial legislation put in place since the crisis, it sees merit in understanding the combined impact of such legislation and identifying any unintended consequences. In particular, the EU Commission sought views on areas of regulation that firms regard as imposing excessive burdens, costs or complexity out of proportion with the intended policy objectives. Specific questions included:

- Has any legislation produced undue obstacles to the ability of the wider financial sector to finance the economy, in particular in relation to SME financing, long-term innovation and infrastructure projects, and climate finance?

- Whether, and to what extent, the regulatory framework has had any major positive or negative impacts on market liquidity and on investor and consumer protection and confidence.

- Have the new rules been appropriately adapted to the diversity of financial institutions in the EU?

There were almost 300 responses to the call for evidence, including from many regulators, governments and central banks. In a feedback paper, the EU Commission highlighted a number of themes that came out of the responses including:
• A significant increase in compliance costs due to the scale and pace of regulatory change and a perceived overlap of different layers of regulation. Concerns were raised as to poorly aligned and tight timelines for implementation and the complexity of the overall framework.

• The need for improvements in financing conditions for SMEs. Many respondents suggested extending capital relief for banks’ investments in bonds and equities issued by SMEs.

• Possible adverse consequences of the LCR and its potential negative impact on corporates’ cash management.

• Specific pieces of legislation and the cumulative effect of certain rules, have given rise to a detrimental impact on market liquidity, particularly in corporate bond markets.

• Disclosure rules are seen as inconsistent across different pieces of relevant legislation.

The EU Commission has stated that none of these views should be regarded as reflecting the position of the commission. It has not yet given a formal response as to whether, and the extent to which, it intends to address the particular issues and concerns it identified.

Considering the vast amount and scope of financial regulation that has been put in place since the financial crisis, it would be surprising if there had not been some unforeseen consequences. In addition, the balance between the need for effective regulation on the one hand but avoiding unnecessary constraints to banks and other financial institutions performing their functions effectively is never going to be easy to calibrate, and the international bodies overseeing the regulatory reform process have stressed the importance of ensuring an appropriate flow of capital to enable the real economy to grow and function efficiently. There is a tendency among some commentators to refer to any relaxing of regulatory rules or delay to implementation of legislation as an unacceptable watering down of financial regulation or evidence of regulators capitulating to the power of banks, but this reaction is hard to justify, at least without a thorough analysis of the circumstances giving rise to the amendment or delay.

There have been a number of public disagreements in relation to certain elements of financial regulation. For example, Sir John Vickers strongly disagreed with the approach of the Bank of England in setting its systemic risk buffers under the U.K. Banking Reform Act 2013, which deviated from the recommendations of the report of the Independent Commission on Banking that he chaired. Also, Francois Villeroy de Galhau a member of the Governing Council of the European Central Bank (ECB) recently expressed concern that current work being done by the BCBS in looking to further develop the Basel III framework is not consistent with earlier commitments to not significantly increase overall capital requirements for banks.

There is, however, widespread agreement that banks are now significantly better capitalized than in the run-up to the financial crisis and better able to withstand a period of sustained financial stress than was previously the case. While there continue to be very different views on the “right” amount of capital for banks to hold, the international reforms highlighted above were never premised on minimum capital being the only answer. The new regulatory framework has to be looked at as a whole. The focus on identifying and mitigating risks arising from shadow banking, increasing investor protection, requiring banks and regulators to focus on recovery and resolution strategies, improved corporate governance, and an increased focus on liquidity and leverage all have a role to play.

Although the bulk of the primary EU legislation aimed at giving effect to the new regulatory framework
is now in place, the EU Commission has indicated a willingness and desire to look at introducing new elements of regulation, including a draft Securitisation Regulation and draft Prospectus Regulation (aimed at overhauling the existing Prospectus Directive) as part of its Capital Markets Union project, seeking to improve the scope and efficiency of the European capital markets. Some EU regulatory initiatives have stalled to some extent, including structural banking reform and the draft Money Market Regulation. In the latter case, work continues and the EU Commission has indicated that it remains committed to finalizing the regulation as part of meeting the FSB’s shadow banking objectives. It is also possible that the political fallout from the U.K.’s referendum vote to leave the EU may cause a delay in some initiatives. It is important that the EU authorities focus on finalizing and implementing the outstanding regulatory agenda but it is erroneous to point to a lack of new legislation and initiatives as evidence that the approach to financial regulation is weakening. The ongoing review of the combined effect of the new regulation is necessary to seek to ensure an appropriate balance between the need for financial regulation and the benefit of having efficient and well-operating financial markets.

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THE LONG LONG GAME:
THE EU FINANCIAL REGULATORY
AGENDA INTO 2016 AND BEYOND

FEBRUARY 2016

A pig in a poke. Whist, whist' (Sir Joseph Mawbey, 1st Bt), by James Gillray, publisher Samuel William Fores (floruit 1841), published 1788.
2016 will mark the eighth anniversary of the collapse of Lehman Brothers and the raft of regulatory reforms introduced in the aftermath of that event and the wider financial crisis will continue to be implemented during the year and in the coming years. Although many of these reforms have now been in the pipeline for a number of years, some new regulation does however continue to be worked on. In particular, in 2015, we saw the initiative to develop a Capital Markets Union (“CMU”) in the European Union (“EU”) which focused on a number of issues including reform of the Prospectus Directive and the introduction of a new regime for simple, transparent and standardised securitisations. Some major pieces of legislation, including the Market Abuse Regulation and the PRIIPs Regulation (both referred to in more detail below), will come into effect during or at the end of 2016 and this coming year will see the finalisation of many regulatory technical standards (“RTS”) and Implementing Technical Standards (“ITS”) in connection with such legislation. Although it looks like implementation of MiFID II will be delayed from 2017 to 2018 (as described more fully below), work will continue in relation to developing the vast number of RTS and ITS that need to be prepared in connection with this legislation.

Although the EU continues to push through its regulatory reform agenda, the cumulative effect of all the new regulation on the financial markets remains uncertain and there are some concerns that there may be unintended and unforeseen consequences arising from the reform agenda. On 20 January 2016, the European Parliament published a resolution on stocktaking and challenges of EU financial regulation. The resolution calls on the EU Commission to pursue an integrated approach to the CMU, pay attention to other relevant policy agendas including the development of a digital single market and threats to cyber security and provide regular (at least annual) “coherence and consistency” checks on a cross-sectoral basis on draft and adopted legislation. The resolution also calls on the EU Commission to publish a green paper exploring new approaches to promoting proportionality in financial regulation and to provide, at least every five years, a comprehensive qualitative and quantitative assessment of the cumulative impact of EU financial services regulation on financial markets and participants, both at EU and member state level. The EU Commission has yet to formally respond to this resolution but the points raised by the EU Parliament in the resolution echo many concerns already raised by market participants.

We have set out below a summary of some of the main regulatory developments we expect to see in the EU during 2016.

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I. EMIR Implementation

The European Market Infrastructure Regulation (“EMIR”)\(^2\) regulating derivatives transactions in the EU entered into force on 16 August 2012, but some of its requirements have yet to come into effect. Further delegated acts, RTS and ITS are required for many of EMIR’s provisions to be effected.

Reporting

Although the trade reporting regime was introduced in February 2014 and expanded in August 2014, recommendations for changes to the RTS and ITS have been made to address practical implementation concerns. In November 2015, the European Securities and Market Authority (“ESMA”) published a Final Report\(^3\) setting out new draft RTS and ITS on data reporting under Article 9 of EMIR.

The RTS include a list of reportable fields with prescriptions of what the content should include. The RTS explain how to report in the situation when one counterparty reports on behalf of the other counterparty to the trade, the information required for the reporting of trades cleared by a CCP and the conditions and start date for reporting valuations and information on collateral.

The ITS include a list of reportable fields prescribing formats and standards for the content of the fields. The ITS define the frequency of valuation updates and various modifications that can be made to the report and a waterfall approach to the identification of counterparties and the product traded. Finally, they describe the timeframe by which all trades should be reported (including historic trades that will need to be backloaded). ESMA has sent the final draft technical standards to the EU Commission for endorsement, which is likely to occur in early 2016.

ESMA published a Consultation Paper\(^4\) in December 2015 on draft RTS relating to data access, and aggregation and comparison of data. It proposed amendments to the current RTS\(^5\) on data access. The draft RTS aim to allow the authorities to better fulfil their responsibilities, in particular in the context of monitoring systemic risk and increased OTC derivatives transparency.

Clearing

The implementation of clearing requirements continues to be progressed. After some back and forth between ESMA and the EU Commission at draft stage, the first RTS on clearing Interest Rate Swaps was published in the Official Journal of the EU on 1 December 2015.\(^6\) The classes of interest rate swaps that will need to be cleared are:

- fixed-to-float (Plain Vanilla) swaps denominated in Euro, GBP, JPY and USD;
- float-to-float (Basis) swaps denominated in Euro, GBP, JPY and USD;
- forward rate agreements denominated in Euro, GBP and USD; and
- overnight index swaps denominated in Euro, GBP and USD.

The RTS divide market participants into categories in order to ensure the most active market participants are required to clear first. The phase-in schedule is as follows:

- 21 June 2016 - Category 1: counterparties that are clearing members of an authorised CCP.
- 21 December 2016 - Category 2: financial counterparties and alternative investment funds ("AIFs") that belong to a group that exceeds a threshold of EUR 8 billion aggregate month-end average outstanding gross notional amount of non-centrally cleared derivatives.
- 21 June 2017 - Category 3: financial counterparties and other AIFs with a level of activity in uncleared derivatives below the threshold of EUR 8 billion aggregate month-end average outstanding gross notional amount of non-centrally cleared derivatives.
- 21 December 2018 - Category 4: non-financial counterparties above the clearing threshold.

The contract date against which the minimum remaining maturity is calculated for Category 1 and Category 2 counterparties was adjusted to allow counterparties time to determine their categorisation and make any necessary arrangements.

ESMA published a Final Report\(^7\) setting out final draft RTS in November 2015 establishing a mandatory clearing obligation on two further classes of interest rate swaps, being:

- fixed-to-float interest rate swaps denominated in CZK, DKK, HUF, NOK, SEK and PLN; and
- forward rate agreements denominated in NOK, SEK and PLN.

As with the first RTS, these RTS propose that the clearing obligation will be phased in depending on counterparty category.

*Risk Mitigation – Collateral*

Article 11(3) of EMIR requires financial counterparties to adopt procedures with respect to the timely, accurate and appropriately segregated exchange of collateral with respect to non-cleared derivatives. The European Supervisory Authorities ("ESAs") (being ESMA, the European Banking Authority ("EBA") and the European Insurance and Occupational Pensions Authority ("EIOPA")) are required to develop RTS as to the necessary procedures, levels and type of collateral and segregation arrangements. In April 2014, the ESAs published their first joint consultation on draft RTS\(^8\) and their second Consultation Paper on draft RTS\(^9\) was published in June 2015 which, among other provisions, prescribed the regulatory amount of initial and variation margin to be posted and collected, and the methodologies by which that minimum amount would be calculated.

The ESAs propose that variation margin be collected over the life of the trade to cover the mark-to-market exposure of OTC derivative contracts. For initial margin, counterparties will be able to choose between a standard pre-defined schedule based on the notional value of the contracts and a more complex internal approach, where the initial margin is determined based on the modelling of the exposures. Assets provided as collateral are subject to eligibility criteria. Once received, margin must be segregated from proprietary assets of the relevant custodian, and initial margin cannot be rehypothecated.

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The second consultation revised the phase-in schedule so that variation margin requirements for uncleared trades are expected to come into effect from 1 September 2016 for major market participants (market participants that have an aggregate month-end average notional amount of non-centrally cleared derivatives exceeding EUR 3 trillion) and on 1 March 2017 for all other counterparties. Initial margin requirements are expected to be phased in between 1 September 2016 and 1 September 2020.

II. Capital Markets Union

In September 2015, the EU Commission launched its Capital Markets Union ("CMU") Action Plan\(^{10}\), intended to cover the 28 EU member states. The CMU initiative was first suggested in response to concerns that, compared with the US and other jurisdictions, capital markets-based financing in Europe is fragmented and underdeveloped, with significant reliance on banks to provide sources of funding. For example, compared with the US, European small and medium-sized enterprises ("SMEs") receive five times less funding from capital markets.

The hope is that this single market for capital will unlock more investment from the EU and the rest of the world by removing barriers to cross-border investment, whilst channeling capital and investment from developed capital markets into smaller markets with higher growth potential. It is intended to provide more options and better returns for savers and investors through cross-border risk-sharing and more liquid markets, with the ultimate aim of both lowering the cost and increasing the sources of funding available.

Based on consultations which began in February 2015, the EU Commission has confirmed that, rather than establishing the CMU through a single measure, it will be achieved through a range of initiatives. These will be targeted towards specific sectors, as well as more generally towards the EU supervisory structure, in each case with the aim of removing the barriers which stand between investors' money and investment opportunities.

The following measures have been designated as priorities: providing greater funding choice for Europe’s businesses and SMEs; ensuring an appropriate regulatory environment for long-term and sustainable investment and financing of Europe’s infrastructure; increasing investment and choice for retail and institutional investors; enhancing the capacity of banks to lend; and bringing down cross-border barriers and developing markets for all 28 member states.

The EU Commission declares this to be a long-term project, with its ultimate goal being a fully functioning CMU by 2019. In order to achieve this, the Action Plan provides that the EU Commission will continuously work to identify the main inefficiencies and barriers to deeper capital markets in Europe and, alongside the annual reports it intends to publish, the EU Commission is also proposing to do a ‘comprehensive stock-take’ in 2017 to decide whether any further measures are required.

The next stage of the CMU implementation will occur in early 2016 when the EU Commission receives responses to two public consultations on (1) access to European venture capital and social entrepreneurship funds and (2) the creation of a pan-European covered bonds market. Also during the course of 2016, the European Parliament and the EU Council of Ministers will consider amendments to the Solvency II Delegated Regulation, as well as proposals for a Securitisation Regulation creating an EU framework for simple and transparent securitisation (see section on EU Securitisation Regulation) as described further below.

III. PD III (Prospectus Regulation)

As part of its implementation of the CMU Action Plan, on 30 November 2015, the EU Commission published a legislative proposal\(^{11}\) for a new Prospectus Regulation ("PD III") which will repeal and replace the current Prospectus Directive 2003/71/EC and its implementing measures. As set out in the EU


\(^{11}\) [http://eur-lex.europa.eu/resource.html?uri=cellar:036c16c7-9763-11e5-983e-01aa75ed71a1.0006.02/DOC_1&format=PDF](http://eur-lex.europa.eu/resource.html?uri=cellar:036c16c7-9763-11e5-983e-01aa75ed71a1.0006.02/DOC_1&format=PDF)
Commission’s Consultation Document\textsuperscript{12} published in February 2015, the EU Commission concludes that the barriers to accessing capital in the EU need lowering and the mandatory disclosure requirements under the Prospectus Directive are particularly burdensome. Therefore, the hope is that implementation of PD III will make it easier and cheaper for SMEs to access capital markets, whilst also simplifying the process for all companies wishing to issue debt or shares.

The key proposals involve the following:

- introducing a higher threshold for determining when a prospectus is required for smaller capital raisings (proposed to be increased from €100,000 to €500,000, with the ability for member states to increase the threshold further in their domestic markets);
- doubling the firm size threshold under which SMEs are allowed to submit a ‘lighter’ prospectus (to include SMEs with a market capitalisation of up to €200 million);
- a simpler prospectus for secondary issuances by listed companies to reflect the reduced risk posed by such issuances;
- shorter, clearer prospectus summaries emphasising only material risk factors;
- fast-track approvals for frequent issuers via a ‘Universal Registration Document’ (the “URD”) (similar to a shelf registration concept); and
- the creation of a free searchable online portal which will act as a single access point for all prospectuses approved in the EEA.

Most other exemptions from the requirement to produce a prospectus, such as for offerings to qualified investors only and to fewer than 150 persons per member state, are proposed to remain unchanged.

As we move further into 2016, the draft PD III will be reviewed by the European Parliament and the EU Council of Ministers. Once approved by all relevant EU institutions, several delegated acts will need to be adopted and ESMA will need to publish draft RTS and guidance. This timetable process is uncertain and it is therefore not presently known when PD III will take effect. The current draft of PD III contemplates that ESMA will produce annual reports on its impact and, in particular, the extent to which the simplified disclosure regimes for SMEs and secondary issuances and the URD are used. The new rules will be evaluated five years after they enter into force.

IV. EU Securitisation Regulation

Securitisations have continued to be criticised in some quarters for the product’s perceived role in causing and/or exacerbating the effects of the recent financial crisis. However during the last couple of years, there have been increasing signs that the securitisation market is viewed by EU regulators as having an important part to play in creating well-functioning capital markets. This is principally due to the role such structures can play in diversifying funding sources and allocating risk more efficiently within the financial system.

On 30 September 2015, the EU Commission published a legislative proposal for a “Securitisation Regulation”\textsuperscript{13} with a view to setting out common rules on securitisation and creating an EU framework for simple, transparent and standardised (“STS”) securitisations. In effect, these are securitisations that satisfy certain criteria and are therefore able to benefit from the resulting STS label (for example, through reduced capital charges). This concept is not dissimilar to the idea that a fund might qualify for the

\textsuperscript{13} http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015PC0472&from=EN
UCITS label. According to the EU Commission, the development of a STS market is a key building block of the CMU and contributes to the priority objectives of supporting job creation and sustainable growth. At the same time, the EU Commission also published a draft Regulation to amend the CRR (referred to and defined below) to provide more favourable regulatory capital treatment for STS securitisations.

The draft Securitisation Regulation has two main goals, the first being to harmonise EU securitisation rules applicable to all securitisation transactions, while the second is to establish a more risk-sensitive prudential framework for STS securitisations in particular. The first goal is to be achieved through repealing the separate, and often inconsistent, disclosure, due diligence and risk retention provisions found across EU legislation, such as the CRR, the Alternative Investment Fund Managers Directive and the Solvency II Directive, and replacing them with a single, shorter set of provisions consisting of uniform definitions and rules which will apply across financial sectors.

The second part of the Securitisation Regulation is focused on the objective of creating the framework for STS securitisations and aims to provide clear criteria for transactions to qualify as STS securitisations. These include RMBS, auto loans/leases and credit card transactions, whereas actively managed portfolios (for example, CLOs), resecuritisations (for example, CDOs and SIVs) and structures which include derivatives as investments have been specifically prohibited. Those transactions which qualify as STS securitisations will result in preferential regulatory capital treatment for institutional investors. The EU Commission’s hope is that in recognising the different risk profile of STS and non-STS securitisations, investing in safer and simpler securitisation products will become more attractive for credit institutions established in the EU and will thus release additional capital for lending to businesses and individuals.

However, market concern exists in relation to the classification of STS securitisations. This, in part, arises as a result of the lengthy list of STS criteria which need to be satisfied and which may be interpreted in different ways. The burden of such interpretation is currently proposed to reside with the issuers and investors, which may introduce uncertainty and a lack of clarity that could ultimately defeat the purpose of the exercise. Some commentators have suggested that a third-party approval mechanism may be beneficial, although it remains to be seen who would be willing to assume this role and whether it is something that EU regulators wish to pursue.

The proposed Securitisation Regulation has been sent to the European Parliament and the EU Council of Ministers who need to agree and approve a final text. It is likely to be subject to considerable debate and scrutiny and it is therefore unlikely to become effective before the end of 2016. That said, market participants are likely to start responding to the proposal by considering whether their transactions fit the criteria for preferential regulatory capital treatment in time for when the Regulation does become effective.

V. MiFID II Implementation

MiFID II is the commonly used term for the overhaul of the Markets in Financial Instruments Directive which originally came into force in 2007. The primary MiFID II legislation comprises a Regulation (“MiFIR”) and recast Directive (together with MiFIR referred to as “MiFID II”). MiFID II was published in the Official Journal of the EU on 12 July 2014 and entered into force 20 days after that date.

MiFID II currently provides that its provisions will start to become effective in the EU in January 2017. However, during 2015, concerns increased as to the work required in relation to the implementation of MiFID II, both in terms of finalising the vast number of delegated acts, RTS and ITS required to be published under MiFID II and in relation to firms putting in place the necessary systems to comply with all of the requirements. ESMA has recommended a delay in the implementation of MiFID II. In November 2015, the European Parliament announced that it is prepared to accept a one-year delay to MiFID II, subject to certain conditions. It is expected that the EU Commission will shortly make a formal legislative proposal to defer the date of implementation to January 2018 but this has not yet been published. It is

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not clear whether the EU Commission will also propose a deferral of the deadline for member states transposing relevant parts of MiFID II into their national laws. This deadline is currently 3 July 2016.

MiFID II significantly expands the scope of the existing MiFID legislation, including:

- some amendments to the investor protection provisions including a narrowing of the execution-only exemption so that structured UCITS are now outside the exemption, together with bonds or other forms of securitised debt that incorporate a structure which makes it difficult to understand the risk involved;
- structured deposits are now subject to a number of the provisions of MiFID II;
- the extension of many provisions of MiFID II to “organised trading facilities” or “OTFs” which will cover many forms of organised trading (not being regulated markets or multilateral trading facilities (“MTFs”)) on which bonds, structured finance products and derivatives are traded;
- requiring all derivatives that are subject to the clearing obligation under EMIR, and that ESMA determines to be sufficiently liquid, to be traded on a regulated market, MTF or OTF;
- extending the pre- and post- trade transparency regime (which currently only applies to shares) to bonds, structured finance instruments and derivatives traded on a trading venue;
- wider product intervention powers granted to ESMA and competent authorities including the ability to temporarily prohibit or restrict marketing of certain products in the EU;
- increased regulation of algorithmic and high frequency trading; and
- significantly expanding the scope of the regulation of commodities and commodity derivatives.

In addition to the level 1 legislation referred to above, MiFID II requires a significant number of delegated acts of the EU Commission to be prepared, mostly comprising RTS and ITS to be drafted by ESMA and the other ESAs. This has resulted in a significant number of consultation papers and discussion papers to be published, including:

(a) in May 2014, a Consultation Paper\textsuperscript{16} and a Discussion Paper\textsuperscript{17} from ESMA outlining its initial thinking on many aspects of MiFID II;

(b) in December 2014, Technical Advice from ESMA to the EU Commission\textsuperscript{18} and a second Consultation Paper on MiFID II\textsuperscript{19} dealing principally with regulation of secondary markets (including a detailed consideration of what constitutes a liquid market for the purpose of granting waivers of pre-trade transparency requirements for bonds, structured finance instruments and bonds and derivatives);

(c) in February 2015, an Addendum Consultation Paper from ESMA\textsuperscript{20} relating to MiFID II, dealing in particular with the transparency rules for non-equity financial instruments including the specification of thresholds for large-in-scale and size-specific waivers for pre- and post-trade transparency requirements for certain derivative transactions;

(d) in April 2015, a Consultation Paper from ESMA\(^{21}\) on draft guidelines for the assessment of knowledge and competence of persons in investment firms providing investment advice or information about financial instruments, investment services or ancillary services to clients under Article 24 and 25 of the MiFID II Directive;

(e) in June 2015, an ESMA Final Report\(^{22}\) on draft ITS and RTS relating to authorisation, passporting, registration of third-country firms and co-operation between competent authorities;

(f) in August 2015, an ESMA Consultation Paper\(^{23}\) on various ITS and RTS to be published under MiFID II that it had not previously consulted on, including the suspension and removal of financial instruments from trading on a trading venue and notification and provision of information for data reporting services providers;

(g) in September 2015, an ESMA Final Report\(^{24}\) setting out the final versions of ITS and RTS it consulted on pursuant to its May 2014 papers referred to above;

(h) in November 2015, an ESMA Final Report\(^{25}\) setting out Guidelines on complex debt instruments and structured deposits in respect of the MiFID II “execution only” exemption;

(i) in December 2015, Final Reports from ESMA on Guidelines\(^{26}\) for cross-selling practices under the MiFID II Directive and on draft ITS\(^{27}\) relating to various matters including position reporting and format and timing of weekly position reports; and

(j) in December 2015, a Consultation Paper from ESMA\(^{28}\) on Guidelines on its draft RTS on transaction reporting, reference data, order record keeping and clock synchronisation.

It is expected that the EU will move to adopt the various delegated acts necessary in connection with the relevant ITS and RTS detailed above. It was expected that this would occur before the July 2016 transposition deadline. As mentioned, if the MiFID II timetable is delayed, it remains to be seen if the transposition deadline is also amended.

In the United Kingdom, on 15 December 2015, the FCA published the first of two Consultation Papers\(^{29}\) on changes to its Handbook necessary to implement MiFID II. This first consultation focused on secondary trading of financial instruments including the rules relating to pre- and post-trade transparency. This consultation is open until 8 March 2016, following which the FCA will publish a Policy Statement. The FCA’s second Consultation Paper on changes to its Handbook dealing with other relevant matters under MiFID II is expected during the first half of 2016.


\(^{29}\) [https://mifid.the-fca.org.uk/](https://mifid.the-fca.org.uk/)
VI. PRIIPS Implementation

The Regulation on key information documents (“KIDs”) for packaged retail and insurance-based investment products (“PRIIPs”)30 ("the PRIIPs Regulation") is set to become effective on 29 December 2016, having come into force in December 2014. The two-year delay was deemed necessary in order to give PRIIPs manufacturers, advisors and sellers sufficient time to prepare for the practical application of the Regulation.

The main aim of the PRIIPs Regulation is to introduce a KID into pre-contractual disclosure, thus enabling retail investors to compare products and make a more informed investment choice when considering buying PRIIPs. The current EU-level regulation of pre-contractual product disclosures is uncoordinated and member states’ application of it has become more divergent which, according to the EU Commission, has created an “unlevel playing field between different products and distribution channels, erecting additional barriers to an internal market in financial services and products”. The worry is that this has led to retail investors making investments without full appreciation of the risks involved and subsequently suffering unforeseen losses.

Therefore, in order to improve the transparency of PRIIPs for investors, the PRIIPs Regulation obligates the manufacturer of a PRIIP (including entities which make significant changes to PRIIPs) to produce a KID which must be provided to each retail investor prior to any contract being concluded. The Regulation contains detailed requirements as to the form and content of the KID, as the aim is for all KIDs to be comparable side-by-side; for example, the KID must be a ‘stand-alone’ document separate from marketing materials, must be a maximum of three sides of A4 paper and the order of items and headings should be consistent throughout all of the documentation. The KID must contain all the information which could be material to an investor, such as the nature, risks, costs, potential gains and losses of the product, but must also be short, concise and avoid financial jargon.

On 11 November 2015, the ESAs released a joint Consultation Paper31 setting out draft RTS relating to presentation, review and provision of the KID. In terms of presentation and content, the draft RTS include a mandatory template to be used for each KID along with the permitted adaptations to the template, a risk indicator scale from 1 to 7 on which PRIIPs must be ranked and the methodology by which to calculate their ranking, a ranking for performance scenarios (unfavourable, moderate and favourable) for the PRIIP and various requirements regarding the presentation of costs. The draft RTS also provide that the KID be reviewed by the PRIIP manufacturer at least every 12 months to ensure it is accurate, fair, clear and not misleading and that the KID is provided in ‘good time’ so that the investor has time to fully consider it.

The ESAs invite comments on the RTS to be submitted by 29 January 2016 and this feedback will be submitted to the EU Commission, along with the final RTS, for endorsement by the end of March 2016. From January 2017, PRIIPs manufacturers and those selling or advising on PRIIPs will need to ensure they provide retail investors with a PRIIPs Regulation compliant KID before entering into any binding contracts.

VII. EU Benchmark Regulation

The integrity of benchmarks used in financial transactions has been the subject of increasing focus from regulators since the investigations into the manipulation of LIBOR and EURIBOR among other benchmarks. It is against this background that the Commission has proposed the Benchmark Regulation32, the draft of which was first published in September 2013.

On 19 May 2015, the EU Parliament agreed to a negotiating mandate on the Benchmark Regulation. Trialogue discussions began in June 2015 with the intention to agree a final version of the Regulation by the end of 2015. On 25 November 2015, the EU Council of Ministers and the European Parliament
reached preliminary political agreement on the proposed Benchmark Regulation. The agreement was formalised by member states at a meeting of the Council’s Permanent Representatives Committee (“COREPER”) on 9 December 2015. The proposed Benchmark Regulation will now be submitted to the European Parliament for a vote at first reading, and to the Council for final adoption. Once adopted, it will apply 12 months from publication in the Official Journal of the EU, and is unlikely to be in force until early 2017, at the earliest.

The proposed Benchmark Regulation aims to improve the governance and controls applicable to financial benchmarks (including proper management of conflicts of interest), improve the quality of input data and methodologies used by administrators and ensure that contributors to benchmarks are subject to adequate controls. The proposed Benchmark Regulation will impose various obligations on benchmark administrators, contributors (including submitters) and users.

The initial draft of the Benchmark Regulation distinguished between critical and non-critical benchmarks and fewer requirements will apply in relation to a non-critical benchmark. If a competent authority considers that the representativeness of a critical benchmark is at risk, the relevant competent authority has the power to take various actions, including requiring selected supervised entities to contribute input data; extending the period of mandatory contribution; determining the form in which, and the time by which, any input data must be contributed; and changing the code of conduct, methodology or other rules of such benchmark. The current political agreement reached in Trialogue between the EU Commission, the EU Council of Ministers and the European Parliament is that there will be three categories of benchmark: critical benchmarks (generally those used as a reference for financial instruments or financial contracts or for the determination of the performance of investment funds having a total value of at least EUR500 billion), significant benchmarks (based on the same criteria as critical benchmarks but with a threshold of EUR50 billion) and non-significant benchmarks (those benchmarks that are not critical or significant on the previous criteria). Obligations under the Regulation will be applied proportionally by reference to these categorisations. There will also be specific regimes distinguishing between commodity benchmarks (based on IOSCO’s principles for oil price reporting), interest rate benchmarks (which include additional requirements relating to input data and contributors) and regulated data benchmarks (which, due to their perceived lower risk of manipulation and conflicts of interest, will be exempt from some requirements).

The proposed Regulation imposes strict control standards and oversight requirements on benchmark administrators. Administrators will need to put in place procedures for controlling input data and reporting infringements. There are also requirements on the transparency of the work undertaken by the administrators in relation to the benchmark. Administrators of critical benchmarks will require authorisation, while administrators of non-critical benchmarks will need to register with ESMA, who will maintain a public register.

In relation to benchmark users, the initial draft Regulation provides that an entity that is subject to supervision in the EU will only be permitted to issue or own a financial instrument or be party to a financial contract which references a benchmark or a combination of benchmarks or use a benchmark that measures the performance of an investment fund if the benchmark is provided by an administrator authorised under the Regulation or is an administrator located outside the EU that is registered by ESMA subject to specified criteria. Concern was raised as to the scope of these provisions, having regard to the fact that no other major jurisdiction outside the EU currently has proposed benchmark regulation as extensive as that proposed in the draft Regulation. Following the Trialogue discussions, the current agreed position is that non-EU indices will be able to continue to be used through a recognition or endorsement regime.

VIII. BRRD Implementation

Having come into force in July 2014, the Bank Recovery and Resolution Directive (“BRRD”) was required to be implemented into EU member states’ national laws by 1 January 2015, except for the provisions relating to the bail-in tool, which should have been implemented by each EU member state by 1 January 2016.
The main aim of the BRRD is to create a framework in which a bank can be allowed to fail, with the minimum of public sector support and the minimum of disruption to the broader financial system. Therefore, in addition to provisions relating to formulating recovery plans, resolution plans and provisions relating to the transfer of businesses and liabilities, the BRRD for the first time in EU law created an additional ‘resolution tool’ for EU national resolution authorities, in the shape of the ‘bail-in tool’. This tool allows national resolution authorities to convert liabilities of the failing bank into equity or to write down the principal amount of those liabilities, so that in this way those liabilities can be forced to absorb some of the losses of the bank entering into resolution.

In addition to the resolution tools, the BRRD also introduced an additional prudential measure, in the form of an obligation to maintain Minimum Required Eligible Liabilities (“MREL”). MREL can be viewed as the European version of the TLAC rules referred to below (in that they provide for each EU national resolution authority to specify, for each bank under its jurisdiction, a minimum level of loss-absorbing capital and liabilities that can credibly be bailed-in in a bank resolution situation). These MREL provisions will apply to EU banks on top of the minimum regulatory capital requirements and capital buffer requirements that have been prescribed by the CRR.

Article 55 of BRRD requires that for most liabilities that can be bailed-in, where the contract for the liability is governed by a non-EU law, the party subject to BRRD must ensure that, in that contract, the beneficiary of the liability acknowledges that the liability can be bailed-in, and agrees to be bound by any such bail-in action.

This Article also became effective from 1 January 2016 and is giving rise to a flurry of activity for EU banks in explaining this obligation to their non-EU counterparties and obtaining their agreement to the inclusion of appropriate wording in the contract. Given that the scope of bail-inable liabilities is so broad, including not only purely ‘financial liabilities’, the intensive efforts needed for banks to comply fully with Article 55 will continue well into 2016 and beyond, until counterparties become familiar with the requirement and its implications.

**IX. TLAC/MREL**

On 9 November 2015, the Financial Stability Board (“FSB”) published its final principles on the amount of loss absorption capacity to be held by global systemically important banks (“GSIBs”)

33. The principles were endorsed at the November 2015 meeting of the G20 nations in Antalya, Turkey. As such, they are now expected to be implemented into the national laws of the G20 nations, although the principles will have no binding effect on any GSIB until its home nation has in fact implemented the principles.

The FSB maintains a list of global banks that it considers to be GSIBs, and updates this list periodically. Currently, the list consists of 30 banks from around the globe.

34. For each bank that is contained on the list, the TLAC principles will establish minimum levels of capital and liabilities that are able to absorb losses in the event of the GSIB’s failure. Those banks that were designated as GSIBs before the end of 2015 and that are not established in an emerging market economy must meet a minimum TLAC requirement, as from 1 January 2019, of at least 16% of their risk-weighted assets, and at least 6% of the denominator for the Basel III leverage ratio. For such firms, these minimum requirements will increase, as from 1 January 2022, to at least 18% of risk-weighted assets and at least 6.75% of the Basel III leverage ratio denominator. For those GSIBs that are currently headquartered in an emerging market economy (which currently encompasses only banks in the People’s Republic of China), these two pairs of minimum figures must be complied with by 1 January 2025 and 1 January 2028, respectively.

Any Tier 1 or Tier 2 capital held towards a GSIB’s minimum capital requirements can also be counted by it towards its TLAC requirements. However, the figures above are exclusive of capital maintained to meet

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the various buffer requirements under the Basel III framework, which buffers must be maintained on top of the minimum TLAC requirement.

In terms of eligibility for TLAC, a liability that does not count as Tier 1 or Tier 2 capital must be unsecured, and must be perpetual in nature or not be redeemable at the instigation of the holder within one year. It must also be subordinated to liabilities that are expressly excluded from counting towards TLAC and must absorb losses prior to such excluded liabilities in insolvency, without giving rise to legal challenge or compensation claims. In addition, such liability cannot be hedged or netted in a way that would reduce its ability to absorb losses in a resolution.

The TLAC principles include a list of liabilities that are excluded from TLAC, on the basis that they may be difficult in practice to bail-in in a resolution, or where there are policy reasons why they should not be bailed-in. These include:

- deposits with an original maturity of less than 1 year;
- liabilities arising from derivatives or instruments with derivative-linked features (such as structured notes);
- liabilities that arise other than through a contract (such as tax liabilities);
- liabilities which are preferred to normal senior unsecured creditors; and
- any other liabilities that are excluded from bail-in under the resolution entity’s national laws, or cannot be bailed-in without risk of a successful legal challenge or compensation claim from the relevant creditor.

2016 will see the beginning of efforts to implement the TLAC principles into national legislation, and this is already evident in Europe in relation to the MREL provisions of the BRRD. The MREL provisions, although they address the same risk as the TLAC principles, differ in certain respects from the TLAC principles. For instance, they apply to all EU banks and not just GSIBs and are to be set on an entity-by-entity basis. They also are intended to be set by national resolution authorities as a percentage of the bank’s own funds and eligible liabilities, on a non-risk-weighted basis. However, sufficient flexibility is built into the MREL provisions that they are expected to meet the TLAC requirements when applied to European GSIBs.

The levels of MREL set by Europe’s national resolution authorities (“NRAs”) will be of significant impact to the European banking industry because, unlike the TLAC principles, a level of MREL must be set for every single European bank, not just GSIBs. Since this is set on an entity-by-entity basis, NRAs will have to apply a certain amount of discretion and judgment in setting the relevant levels. However, each NRA will be required to comply with the RTS (currently still in draft form) prescribed by the European Banking Authority (EBA) in respect of the setting of MREL. These standards provide that a bank’s MREL must consist of both an amount necessary for loss absorption prior to and during resolution, as well as an amount necessary for the subsequent recapitalisation of the bank. The loss absorption amount will have to at least equal the minimum capital requirement prescribed by the EU’s Capital Requirements Regulation (defined below), together with any applicable leverage ratio requirement that is set by the relevant national competent authority.

In the United Kingdom, the Bank of England has already set out its proposals as to the principles it will apply in setting MREL for each bank under its auspices. In particular, it has stated that it intends to use its MREL-setting powers to reflect the FSB’s TLAC principles in relation to UK-based GSIBs.

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36 http://www.bankofengland.co.uk/financialstability/Documents/resolution/mrelconsultation2015.pdf
The Bank of England has stated that for the biggest/most complex UK banks, it intends to set MREL at a level equivalent to twice the bank’s current minimum capital requirements – once for the loss absorption portion and once for the recapitalisation portion. Although not strictly required by the BRRD, the Bank of England also proposes that MREL liabilities should be subordinated to senior operating liabilities of the relevant bank.

The issue of subordination of certain liabilities, in the context of MREL and TLAC, is and will remain throughout 2016, a controversial subject. MREL – or TLAC – eligible liabilities are required to be subordinated to other unsecured liabilities that cannot be bailed-in or are unlikely to be bailed-in in a resolution situation. This subordination is required in order to prevent a myriad of claims that might arise from bailed-in creditors in circumstances where other equal-ranking unsecured liabilities, in particular deposits, have not been bailed-in, and the bailed-in creditors have suffered detriment as a result.

However, different EU member states are using different methodologies to achieve this subordination. For instance, the United Kingdom has enacted legislation which bestows a priority status on bank deposits of individuals and micro and small and medium enterprises. In contrast, Germany proposes to enact legislation which will provide that certain bank bonds are automatically subordinated to depositors and other unsubordinated liabilities. However, the precise methodology and wording used to achieve subordination of certain bail-inable liabilities could have a huge impact on the market for senior unsecured bank bonds and other liabilities, and we expect many developments in this regard during 2016.

X. CRD IV/Basel III

The Basel III reforms, in the form of the Capital Requirements Regulation (“CRR”) and the CRD IV Directive (together with the CRR referred to as “CRD IV”), largely came into effect on 1 January 2014 in Europe. This included the revised requirements in relation to minimum capital requirements for firms and the introduction of new capital buffers. These requirements are now being phased in in accordance with the terms of CRD IV.

Although the principal minimum regulatory capital requirements started to apply from 1 January 2014, a number of the other provisions take effect at a later date, in particular those relating to the liquidity coverage and stable funding ratios, leverage ratio and systemic buffers referred to below.

Liquidity Coverage Ratio (“LCR”)

In October 2014, the EU Commission adopted a delegated Regulation in relation to the LCR mandated by the Basel III framework, containing detailed provisions for the ratio which requires firms to hold an adequate level of high-quality liquid assets to meet net cash outflows over a 30 day stress scenario period. The delegated Regulation generally followed the Basel III LCR standard, with certain amendments, including in relation to giving certain covered bonds extensive recognition and also including, as part of the permitted liquid assets, certain types of securitised assets, such as securities backed by auto loans. The LCR started to be phased in from 1 October 2015, commencing at 60% of the full requirement and rising to 100% of the full requirement by 1 January 2018 unless the EU Commission exercises its power to delay full implementation until 1 January 2019.

Net Stable Funding Ratio (“NSFR”)

The NSFR is also prescribed by the Basel III framework and provides for a longer term amount of stable funding to be available. A bank must have “available stable funding” to meet 100% of its “required stable funding” over a one-year period. There are, as yet, no binding requirements as to the NSFR in CRD IV. However, as required by the CRR, in December 2015, the EBA published a Report in relation to the...

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introduction of the NSFR in the EU. In the Report, the EBA recommends the introduction of the NSFR in the EU and concludes there is likely to be no need to exempt certain banks from the NSFR requirements, although it states that it will explore further the costs for smaller banks in implementing the requirements. The EU Commission is now required to submit a legislative proposal in relation to the introduction of the NSFR in the EU by 31 December 2016. The Basel III framework envisages the introduction of the NSFR by 1 January 2018. This timetable is also envisaged by the recitals to the CRR but further details on timing will be included in the draft legislation to be published by the EU Commission.

Leverage Ratio

The ratio also forms part of the Basel III framework and is a measure of a firm’s Tier I capital divided by the non-risk weighted values of its assets. Basel III provides for such ratio to be a minimum of 3%. Following the current period of bank-level reporting of the leverage ratio and its components to national supervisory authorities, the Basel Committee on Banking Supervision (“BCBS”) intends to make any final calibrations and amendments to the requirements by 2017 with the intention that a minimum leverage ratio requirement will become effective from 1 January 2018. Title VII of the CRD IV Directive contains some measures implementing the Basel III leverage ratio requirements. In addition, in October 2014, the EU Commission adopted a delegated Regulation making changes to the calculation of the leverage ratio by amendments to the capital measure and the total exposure measure. These included provisions to address the treatment of the exposure values of derivatives and securities financing transactions.

The EBA is required to publish a report on the impact and effectiveness of the leverage ratio by 31 October 2016. The EBA has indicated that it intends to publish the report by July 2016 at the earliest. Following publication of such report, the EU Commission is required to submit its legislative proposal, if appropriate, for a delegated act implementing the leverage ratio.

Systemic Buffers

In addition to the minimum capital requirements, Basel III also introduced capital buffers which apply to credit institutions and certain investment firms. These comprise (i) a capital conservation buffer of 2.5% of risk weighted assets (“RWAs”) comprised of common equity tier 1 capital (“CET1”) (which if not met, will result in a limitation of the maximum amount of profits that be distributed by the firm), (ii) a countercyclical buffer that can be set by national supervisory authorities of up to 2.5% of RWAs and must again comprise only CET1 and (iii) systemic risk buffers referred to below. The capital conservation buffer and the countercyclical buffer started to be phased in on 1 January 2016 and will be fully implemented by 1 January 2019. In December 2015, the EBA published an Opinion on the interaction of Pillar 1 and Pillar II requirements under Basel III / CRD IV and the combined buffer requirements and restrictions on distributions. In the Opinion, the EBA recommended, among other things, that competent authorities ensure that the CET1 capital taken into account for calculating the maximum distributable amount where the capital conservation buffer is not met should be limited to the amount not used to meet the Pillar 1 and own funds requirements of the firm. It also recommended that authorities consider requiring firms to disclose their MDA-relevant capital requirements.

Under CRD IV, national competent authorities must assess global systemically important institutions (“G-SIIs”) and other systemically important institutions (“O-SIIs”). Each G-SII will be placed into one of five sub-categories. CRD IV imposes an additional buffer for each G-SII of between 1% and 3.5% of RWAs. Competent authorities will also have the discretion to impose a buffer on O-SIIs of up to 2.5% of RWAs. In each case, these buffer requirements must be met by CET1 capital and are in addition to a firm’s minimum capital requirements and capital conservation and countercyclical buffers. Member states will also have the power to introduce a systemic risk buffer, comprised of CET1 capital, which can be applied to the financial sector (or subsets of such sector). These buffers can be up to 3% of RWAs for all exposures and up to 5% of RWAs for domestic and third country exposures. These buffers are not intended to be cumulative with the G-SII buffer and the O-SII buffer. Only the highest will apply to a firm.

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The EBA published a Consultation Paper\(^43\) in April 2015 in relation to a draft Regulation amending the RTS on the identification methodology for G-SIIs, which Regulation had previously been published in October 2014 and a draft Regulation amending the ITS on uniform format and dates for the disclosure by G-SIIs. In January 2016, the EBA published a Final Report\(^44\) on final draft RTS in relation to such amendments.

Remuneration

CRD IV also contains provisions relating to firms' remuneration policies. These require firms to ensure that their remuneration policies make a clear distinction between criteria for setting basic fixed remuneration and variable remuneration. CRD IV also sets out a number of principles on variable remuneration, most controversially that a person's variable remuneration should not exceed the amount of fixed remuneration (with the possibility of it being 200% of fixed remuneration only with shareholder approval (66% majority required with a minimum quorum of 50%)). This has been referred to as the “bonus cap”. Variable remuneration must also be subject to clawback arrangements. The bonus cap will therefore continue to be applicable into 2015. Concerns were raised by the EBA and the EU Commission during 2014 as to the practice by some firms of redesignating some variable pay into allowances. Their view was that in many cases, the allowances would still be regarded as variable pay. In October 2014, the EBA published an Opinion\(^45\) outlining what sort of pay structures it would consider to be variable pay. However, the paper has no binding force in the EU, and it is therefore possible that some firms could press ahead with allowance-type arrangements, leaving open the possibility of competent authorities seeking to impose sanctions and possible future legal action in this area.

In May 2015, the EBA published correspondence between it and the EU Commission as to the interpretation of the proportionality principle set out in Article 92(2) of the CRD IV Directive that states that the remuneration principles should be applied to firms in a manner and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities. The EU Commission's view is that the remuneration principles under CRD IV have to be applied to each firm and any discretion those provisions may leave to member states and competent authorities have to be exercised in accordance with the proportionality principle. Therefore, the EU Commission is of the view that the proportionality principle does not disapply any of the remuneration principles and that requirements on deferral and payment in instruments have to be applied to all institutions.

In December 2015, the EBA published an Opinion\(^46\) on the application of the proportionality principle. It also published a Final Report on its Guidelines in relation to the CRD IV remuneration requirements.\(^47\) The revised Guidelines will come into force on 1 January 2017 and will apply on a “comply or explain” basis so that national competent authorities will have to state whether they intend to comply with the Guidelines and, if not, the reason for not doing so. In the Opinion, the EBA repeats its view in relation to the proportionality principle stated above. It also proposes amendments to CRD IV that would permit smaller and less complex firms to disapply the requirements in relation to deferral and payment in instruments. It does not propose any amendment to the bonus cap. This would mean that all CRD IV firms would have to apply the bonus cap from 1 January 2017 (including all asset managers and investment firms coming under CRD IV). At present, the UK FCA only requires CRD IV firms in levels 1 and 2 of its proportionality framework to apply the bonus cap.

It is expected that the EU Commission will publish its report on the application and impact of the CRD IV remuneration rules in the first half of 2016 which will address the issues raised by the EBA, including possible amendments to the relevant provisions of CRD IV.


\(^{47}\) [https://www.eba.europa.eu/documents/10180/1314839/eba+gl+on+sound+remuneration+policies.pdf/1b0f3999-f913-461a-b3e9-fa0064b1946b](https://www.eba.europa.eu/documents/10180/1314839/eba+gl+on+sound+remuneration+policies.pdf/1b0f3999-f913-461a-b3e9-fa0064b1946b)
XI. UK Ring-fencing

Since this time last year, there have been very few developments in the implementation of the UK’s Financial Services (Banking Reform) Act 2013. This Act requires retail banking services to be ring-fenced from other bank activities. Although the base legislation has now been in force for some time in the UK, the precise details of exactly what will be required to comply with the new ring-fencing regime, by its proposed implementation date of 1 January 2019, are to be provided by secondary legislation to be passed by the UK Treasury. However, there has so far been no sign of any further draft legislation in this regard, making it very difficult for UK banks to make definitive plans as to how to reorganise their businesses.

What is known is that the ring-fenced retail entity can remain as part of the broader banking group, so long as it is functionally and legally separated. The legislation will catch firms that, on a three-year average period, hold more than £25 billion worth of core deposits, meaning all deposits other than from financial institutions, large to medium sized companies and high net worth individuals. In order to be able to survive the failure of another member of the banking group, the ring-fenced banks will be subject to stand-alone prudential rules, including minimum capital requirements, leverage ratios, liquidity ratios and risk buffers.

Such banks will be prevented from undertaking excluded activities, such as dealing in investments as principal and commodities trading, although it is possible that further activities may in the future be specified as excluded for this purpose. Generally, they will not be able to engage in investment banking activities, but they will be able to offer limited types of derivatives to their customers, such as derivatives commonly used to hedge currency and interest rate risk.

At the end of January 2016, the Financial Policy Committee of the Bank of England (the “FPC”) published a Consultation Paper48 on its proposals for a framework for the systemic risk buffer that it is required to develop pursuant to the Capital Requirements (Capital Buffers and Macro prudential Measures) Regulations 2014. This systemic risk buffer (“SRB”) is intended to apply, inter alios, to ring-fenced banks and is part of the UK’s framework for identifying and setting higher capital requirements for domestic systemically important banks.

The FPC proposes that each ring-fenced bank will be required to hold a certain amount of Tier 1 capital in addition to its minimum capital requirements, its capital conservation buffer and any countercyclical capital buffer. The amount of required additional Tier 1 capital will range from 1% of RWAs for banks with total assets of £175 billion or greater to 3% of RWAs for banks with total assets of £755 billion or greater (although the FPC expects that the largest ring-fenced banks will have an initial SRB rate of 2.5%).

The SRB is proposed to apply in tandem with the implementation date for the ring-fencing regime, and the consultation will remain open for comments until 22 April 2016.

UK banks will need to see many more details of the ring-fencing regime during the course of 2016, in order that they can make necessary preparations in time for the proposed implementation date of 1 January 2019.

XII. Possible EU Banking Reform

As we noted in last year’s “From EMIR To Eternity?”49, the draft Regulation50 on EU-level bank structural reform published by the EU Commission had been expected to be considered by the European Parliament during its April 2015 session, and adopted by June 2015. That has not happened.

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48 http://www.bankofengland.co.uk/financialstability/Documents/fpc/srb_cp.pdf
49 http://www.mofo.com/~/media/Files/ClientAlert/2015/01/150105FromEMIRToEternity.pdf
Currently, the EU Council of Ministers and the European Parliament are considering the EU Commission’s legislative proposal. It is now expected that the European Parliament will decide on its negotiating position on the legislative proposal during the first half of 2016, and will attempt to reach political agreement with the Council in the latter part of 2016. However, even those estimates are very tentative, bearing in mind the history of this draft Regulation so far, and the fact that this topic remains highly politically sensitive.

It was originally proposed that the provision in the Regulation as to prohibition of proprietary trading would become effective on 1 January 2017 (six months after the publication of a list of covered and derogated banks), and the provisions regarding potential separation of trading activities would become effective on 1 July 2018. Given the delay in the progress of this Regulation, these timings will almost certainly need to change.

XIII. FCA Senior Managers Regime

The Approved Persons Regime (the “APR”) which has, up to the start of 2016, applied in the UK was set up with the objective of ensuring the quality of individuals working in certain roles within the financial services industry, and thereby providing protection of consumers and the UK financial system. Under the Financial Services and Markets Act 2000 (“FSMA”), only persons classified as “approved persons” by either the FCA or the PRA were permitted to perform certain key functions, known as “controlled functions”, for authorised firms. Such approval could only be granted if the candidate was a “fit and proper” person to perform the function to which the application relates.

The APR, however, came under considerable criticism from the Parliamentary Commission on Banking Standards (the “PCBS”) in its June 2013 Final Report titled ‘Changing Banking for Good’ in which the APR was described as a “complex and confused mess” which has created “a largely illusory impression of regulatory control over individuals”. The report made several recommendations which resulted in amendments being made to FSMA to replace the APR for banks, building societies, credit unions and investment firms (through the Financial Services (Banking Reform) Act 2013).

In July 2014, the FCA and the PRA published a joint Consultation Paper on a new framework for individual accountability, with proposals for a Senior Managers’ Regime (“SMR”) and a Certification Regime (“CR”) (collectively the “SMCR”) in line with the PCBS’s recommendations. From 7 March 2016, these two new regimes, along with revised Conduct Rules, will replace the APR for banking sector firms (this includes UK banks (including UK branches of foreign banks), building societies, credit unions and PRA-approved investment firms), and new senior managers will appear on the FCA register from that date. The UK government has also confirmed that, following the Fair and Effective Markets Review (“FEMR”) report’s recommendations, the new framework will be extended to all UK authorised financial institutions from 2018.

Broadly, the SMR’s aim is to ensure that senior managers who are recognised as performing a senior management function (“SMF”) can be held accountable for any misconduct that falls within their areas of responsibilities. This is done by requiring firms to allocate SMFs to their senior managers and then assigning prescribed responsibilities to these SMFs to ensure that there is an individual accountable for every aspect of a regulated activity within a firm. The CR applies to other staff who could pose a risk of significant harm to the firm or any of its customers and firms will need to ensure they have procedures in place for assessing the fitness and propriety of staff, for which they will be accountable to the regulators.

Individuals who are currently approved under the APR need to be ‘grandfathered’ into relevant SMR roles via a notification, the submission deadline for which is 8 February 2016, accompanied by corresponding statements of responsibility for each individual and the firm’s responsibilities map.

53 http://www.bankofengland.co.uk/markets/Pages/fmreview.aspx
In relation to insurers, the Solvency II Directive mandated regulators to update the existing APR and so the PRA introduced the Senior Insurance Managers Regime (“SIMR”). The SIMR aims to ensure that all insurance firms and groups have a clear and effective governance structure, and to clarify and enhance the accountability and responsibility of individual senior managers and directors. The elements of the SIMR which needed to be in force for the UK to implement Solvency II entered into force on 1 January 2016, whilst the remaining elements will enter into force alongside the SMCR on 7 March 2016. As the SMCR is set to be extended to insurers as of 2018, it is likely that the SIMR will only be operational for a short time.

XIV. AIFMD

The Alternative Investment Fund Managers Directive54 (the “AIFMD”) and its supplementary Regulation came into effect in the EU in July 2013 and introduced a centralised rulebook for the management and marketing of alternative investment funds (“AIFs”) by alternative investment fund managers (“AIFMs”) within the EU.

The concept of an AIF is fairly broad and is defined as a collective investment undertaking (including investment compartments thereof) which is not a UCITS fund but which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors. However, certain entities and arrangements are expressly excluded, such as segregated managed accounts, family offices, joint ventures, insurance contracts and certain special purpose vehicles. Furthermore, AIFs which are categorised as ‘small AIFs’ are exempted from many of the provisions of the AIFMD and where the aggregate assets of all AIFs under an AIFM’s management do not exceed the relevant thresholds, that AIFM will only have basic obligations in relation to registration and notification of certain information.

An AIFM is a legal person whose regular business is the managing of one or more AIFs by, for example, performing portfolio or risk management activities. Each AIF within the scope of the AIFMD must have a single authorised AIFM for AIFMD purposes, although it can continue to utilise the services of multiple entities for management and administration activities. Aside from having to be authorised, AIFMs are subject to supervision by their home competent authority, must meet capital requirements of at least €125,000 and meet various additional requirements such as having appropriate governance and conduct of business standards and systems in place to manage risks, liquidity and conflicts of interest. The AIFMD also aims to enhance the transparency of AIFMs and the funds they manage by imposing on them various transparency requirements, including reporting obligations (to the relevant competent authorities) and detailed disclosures in annual reports.

The AIFMD does not only apply to funds and managers based in the EU. Any non-EU AIFMs that market one or more AIFs managed by them to professional investors in the EU are currently subject to the national private placement regime of each of the member states where the AIFs are marketed or managed.

The AIFMD provides for the possibility in the future of an ‘AIFMD passport’ by which a non-EU AIFM that has complied with the full rigour of the AIFMD’s requirements can market its funds throughout the EU following a simplified regulatory notification process. A similar passport regime is already in place for EU AIFMs. It was hoped that the passporting regime for non-EU AIFMs would come into play during 2015. However, despite a positive recommendation from ESMA in July 2015 (for extension of the passport regime to Guernsey, Jersey and, with certain amendments, Switzerland) the EU Commission has not adopted the delegated act specifying when the passporting regime will become effective. It is unclear how long it will be before the regime comes into effect, as ESMA is conducting a country-by-country analysis of whether the AIFMD passport should be extended to each jurisdiction and has recommended that the extension of the passport be deferred until it has delivered positive recommendations for a sufficient number of non-EU countries. It is expected that ESMA will deliver its Opinions on the second group of non-EU jurisdictions (amongst them the Cayman Islands, Australia, Canada and Japan), along

with a final conclusion on those it was considering in its first recommendation (Hong Kong, Singapore and the USA) by March 2016. Aside from this, there is also a concern that the delay may be extended further as it is unclear whether (under the AIFMD itself) it is possible to extend the passport on a country-by-country basis.

In addition to the passporting developments, in 2016, ESMA is expected to publish revised guidelines on sound remuneration policies and finalise its guidelines on asset segregation under the AIFMD. By July 2017, the EU Commission is expected to start a review on the application and scope of the AIFMD as a whole.

XV. Shadow Banking

The FSB has been spearheading a review of “shadow banking” since the financial crisis in light of concerns that shadow banking entities and activities contributed to the crisis and subsequent concerns that increased regulation in the banking sector since the crisis could push certain banking activities into the less regulated sectors. The FSB refers to “shadow banking” as a system of credit intermediation that involves entities and activities that are outside the regular banking system, although it has stressed that this is not a rigid definition and should be adapted according to the financial markets. The FSB has been coordinating various international workstreams and has, together with ISOCO, developed a package of policy recommendations which have been endorsed by the G20 leaders.

Most recently, in November 2015, the FSB published various reports, including on transforming shadow banking into resilient market-based finance, the Global Shadow Banking Monitoring Report for 2015 (part of its annual shadow banking monitoring exercise) and a Report finalising recommendations on a regulatory framework for haircuts on non-centrally cleared securities financing transactions (referred to below). The FSB has also updated its roadmap, which outlines certain specified tasks for IOSCO, the Basel Committee on Banking Supervision and the FSB itself.

The EU Commission has also identified resolving the issues surrounding shadow banking as a priority and published its “Communication” on shadow banking in September 2013 as a roadmap for the EU Commission’s future work in the area. The EU Commission has endorsed the FSB’s general definition of shadow banking and given an indication of the activities (primarily securitisation, securities lending and repos) and entities (including SPVs performing liquidity and/or market transformation and money market funds) which it believes fall within the definition.

Two areas highlighted in both the FSB’s workstreams and in the EU Commission’s Communication for specific regulatory developments are securities financing transactions and money market funds. The current status of each is as follows:

(a) Securities Financing Transactions: One of the FSB’s main priorities has been assessing financial stability risks and developing policy recommendations to strengthen regulation of securities lending and repos, as it believes that the majority of such transactions are entered into by non-banks, thus giving rise to maturity and liquidity transformation risks outside the banking sector. These are of particular concern, as the securities lending and repo markets are vital for facilitating market-making, supporting secondary market liquidity and meeting many financial institutions’ financing needs.

On 12 November 2015, the FSB published a Report finalising its policy recommendations on a regulatory framework for haircuts on non-centrally cleared securities financing transactions (to apply numerical haircut floors to non-bank-to-non-bank transactions). The framework is intended

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to limit the build-up of excessive leverage outside the banking system and to help reduce procyclicality of that leverage.

In November 2015, the EU Council of Ministers adopted the EU Commission’s proposed Regulation on transparency of securities financing transactions (“SFT Regulation”), and the final text was published in the Official Journal of the EU on 23 December 2015. The SFT Regulation provides for details of all SFTs to be reported to trade repositories, similar to the reporting requirements for OTC derivatives under EMIR, and imposes additional disclosure requirements on managers of UCITS and AIFs. Furthermore, in relation to rehypothecation, the SFT Regulation’s “reuse” arrangements require that counterparties must consent in writing to an asset being rehypothecated in the case of a security financial collateral arrangement, the risks of rehypothecation must be explained in writing to the collateral provider and assets received as collateral must be transferred to an account opened in the name of the receiving counterparty.

The SFT Regulation entered into force on 12 January 2016 and the vast majority of its provisions have applied from that date.

(b) Money Market Funds (“MMFs”): Historically MMFs have been regarded as a safe investment with a stable net asset value (“NAV”). The FSB considers MMFs to be an important element of the shadow banking system, both as a source of short-term funding for banks and for provision of maturity and liquidity transformation. It notes, however, that during the financial crisis, some MMFs suffered large losses due to holdings of ABS and other financial instruments, leading to significant investor redemptions and instability. IOSCO published two reports in April and October setting out policy recommendations for a common approach to MMF regulation, including the need for compliance with general principles of fair value when valuing securities in a portfolio, the requirement to hold a minimum amount of liquid assets to meet redemptions and prevent fire sales and the requirement that MMFs offering a stable NAV should be subject to measures designed to reduce the specific risks associated with this feature. In accordance with these recommendations, the SEC adopted new rules on MMFs (which were established after October 2014), resulting in the imposition of a floating NAV requirement for non-retail and non-governmental MMFs.

The EU Commission has supported the FSB’s analysis of the importance of MMFs and agreed that they need to become more resilient to crises. As a result, the EU Commission has proposed a Regulation (“MMF Regulation”) which will introduce a framework of requirements to enhance the liquidity and stability of MMF funds. Key provisions in the MMF Regulation include:

- prescribed levels of daily and weekly liquidity; the requirement to clearly indicate whether an MMF is a short-term MMF (those holding assets with a residual maturity of 397 days or less) or a standard MMF;
- the imposition of a capital buffer of 3% for constant NAV funds;
- the requirement that some internal credit risk assessment is carried out by the MMF manager to avoid over-reliance on external credit ratings; and
- the introduction of customer profiling policies in order to anticipate large-scale redemptions.

The European Parliament approved amendments to the MMF Regulation during a plenary session on 29 April 2015 and the MMF Regulation is currently with the European Parliament and the EU Council of Ministers for negotiation and adoption. The capital buffer referred to above is a particularly contentious issue. There is, as yet, no clear timetable for the MMR Regulation to be approved and adopted during 2016.

XVI. MAR / MAD II Implementation

From 3 July 2016, the Market Abuse Regulation (Regulation 596/2014) (“MAR”) will repeal and replace the existing Market Abuse Directive (2003/6/EC) (“MAD”) and its implementing legislation. MAR was part of a revised legislative package governing market abuse adopted by the EU Council of Ministers in April 2014 along with the Criminal Sanctions for Market Abuse Directive (“CSMAD”) (together known as “MAD II”). The aim of these changes is to strengthen the market abuse regulatory framework and bring the instruments and markets within its scope into line with the proposed new MiFID II regime. With the objectives of enhancing market integrity and investor protection, the new regime will, among other things, bring the manipulation of benchmarks within the scope of the legislation and make the manipulation of markets a criminal offence.

The UK has exercised its powers under the Lisbon Treaty to opt out of measures governing EU criminal law and thus has not signed up to CSMAD. All other member states (with the exception of Denmark, who also opted out) must transpose the CSMAD provisions into national law by 3 July 2016. UK firms operating across member states’ borders should be aware of the provisions since they could incur liability in those jurisdictions subject to CSMAD.

The principal changes that will be brought into effect under MAR include an extension of scope to cover a broader range of securities than is presently covered under MAD. Whereas MAD regulates derivatives traded on the EU’s primary investment exchanges (or regulated markets), MAR will borrow the definition of ‘financial instruments’ introduced by the MiFID II Directive and thereby include instruments traded on MTFs and OTFs, as well as those that may be traded off-market but can have an effect on such instrument. The scope of regulatory coverage for the following instruments is also extended: emission allowances and related auctioned products, commodity derivatives and related spot commodity contracts and benchmarks.

MAR also introduces a new offence of ‘attempted’ insider dealing and market manipulation, and includes a prohibition on certain automated trading methods using algorithmic trading or high-frequency trading strategies which can be used to manipulate markets. Further, market participants subject to MAR will need to adjust their internal compliance procedures to ensure they comply with the new requirements on insider lists, notification obligations and directors’ dealings, amongst other changes. Although the bulk of MAR provisions will automatically apply to all member states on 3 July 2016, certain provisions relating to OTFs, SME growth markets, emission allowances and related auctioned products will not apply until 3 January 2017, when MiFID II becomes applicable. It is not yet clear how the proposed delay in MiFID II referred to above will impact this timetable.

On 28 September 2015, ESMA published a final report containing draft RTS and ITS on MAR and, in response, the European Commission adopted a Delegated Regulation supplementing MAR on 17 December 2015. This Delegated Regulation covers rules regarding indicators of market manipulation, minimum thresholds for exemption of certain participants in the emission allowance market from the requirement to publicly disclose inside information, the competent authority for notifying delays in disclosures, permission for trading during closed periods, types of notifiable managers’ transactions and exemption from MAR for certain third countries’ public bodies and central banks. The Regulation will come into force along with MAR in July 2016.

On 28 January 2016, ESMA published a Consultation Paper on draft Guidelines under MAR relating to persons receiving market soundings and on the legitimate interests of issuers to delay insider information and situations in which the delay of disclosure is likely to mislead the public. This consultation is open until 31 March 2016.

In the UK, there are several ongoing consultations related to MAR. Responses to the FCA’s November 2015 Consultation on delaying disclosure of inside information under the Disclosure and Transparency Rules69 must be submitted by 20 February 2016, and the deadline for responses to its consultation titled ‘Policy proposals and Handbook changes related to the implementation of the Market Abuse Regulation’70 is 4 February 2016. HM Treasury is also consulting on the Financial Services and Markets Act 2000 (Market Abuse) Regulations 2016, a draft statutory instrument which would implement MAR into UK legislation. Comments on this draft statutory instrument are due by 4 February 2016, and it will then be subject to further policy and legal review.

XVII. UCITS V

The UCITS V Directive was published in the Official Journal of the EU on 28 August 201471 and makes various changes to the existing UCITS Directive (“UCITS IV”).72 It came into force on 17 September 2014, and EU member states have until 18 March 2016 to transpose it into their national laws. The principal amendments made by UCITS V seek to make some of the rules for UCITS funds more consistent with those applicable to alternative investment funds under the AIFMD and include:

- changes to the provisions relating to the appointment of a depositary in respect of a UCITS fund;
- rules setting out the terms on which the depositaries’ safekeeping duties can be delegated;
- revision of eligibility criteria for depositaries so that only credit institutions and investment firms will be able to act as depositaries;
- clarification of scope of a depositary’s liability in the event of losses relating to an asset held by the depositary;
- the requirement that UCITS management companies put in place remuneration policies and practices for senior management and persons whose professional activities have a material impact on the risk profile of the management company or the UCITS;73 and
- imposition of minimum harmonisation rules to seek to provide more consistency in sanctions provisions in member states.

UCITS V requires the EU Commission to publish and implement various delegated acts and technical standards and guidance. In particular, the EU Commission has to set out various requirements as to the rules relating to depositaries. ESMA published a Consultation Paper in September 201474 in relation to such delegated acts. Following this consultation, the EU Commission adopted a Delegated Regulation on 17 December 2015 which included:

(a) minimum requirements to be included in the contract between the depositary and the management / investment company;

(b) certain duties and obligations on the depositary including safe-keeping, custody and ownership verification, oversight and record-keeping;

(c) provisions relating to insolvency protection of the assets of the UCITS, including due diligence and asset-segregation obligations when appointing delegates to perform safe-keeping duties; and

(d) liability of the depositary in circumstances where custody assets are lost by the depositary or a third party; and

(e) requirements relating to the independence of management companies, investment companies, depositaries and third parties to whom the safekeeping function has been delegated.

The Delegated Regulation is still subject to approval by the European Parliament and the EU Council of Ministers. It is expected this process will be completed during the early part of 2016, following which it will be published in the Official Journal of the EU and come into force on the 20th day following such publication. Its provisions will become effective six months after it comes into force.

In addition, on 23 July 2015, ESMA published a Consultation Paper on proposed Guidelines on sound remuneration policies under UCITS V and the AIFMD. These Guidelines aim to clarify the specific provisions in UCITS V in relation to remuneration to ensure a consistent application with the equivalent provisions in the AIFMD and to provide guidance on certain provisions, including those relating to proportionality, the governance of remuneration, risk alignment and disclosure. Provisions in the guidelines which are consistent with the approach in relation to the AIFMD include:

(a) only certain remuneration principles may be disapplied if proportionate to do so, including payment of variable remuneration in instruments, deferral of payments of variable remuneration, the clawback provisions and the requirement to establish a remuneration committee;

(b) requirements in relation to staff to which investment management activities have been delegated, including a requirement that delegates are subject to remuneration requirements at least as effective as those under the remuneration Guidelines referred to above, and there are appropriate contractual arrangements to ensure there is no circumvention of the remuneration rules; and

(c) certain disclosure requirements in relation to remuneration in the UCITS prospectus and annual report.

ESMA is expected to publish its final Guidelines in the first half of 2016 although it is not clear that these will be published before 18 March 2016 when member states are required to transpose UCITS V into national laws. This would mean UCITS managers would be subject to the UCITS V remuneration rules but without having the benefit of the Guidance.

Many member states are in the process of ensuring compliance with the 18 March 2016 transposition requirement. In the UK, in October 2015 HM Treasury published an open consultation in relation to the implementation of UCITS V in the UK.76

XVIII. SRM Regulation

Closely linked to the BRRD is the Single Resolution Mechanism (“SRM”), which forms part of the European Banking Union. The aim of the SRM is to apply a uniform resolution process to all banks established in EU Member states that are participating in the Single Supervisory Mechanism (“SSM”), in other words all banks in the Eurozone and other member states that are participating in the SSM. Under the SSM, the European Central Bank acts as the ultimate supervisor for all the banks subject to the SSM.

The SRM (which is constituted by the SRM Regulation77) is extremely closely related to the BRRD and mirrors the resolution tools and options available under the BRRD. The important difference is that a Single Resolution Board (“SRB”) is appointed to perform most of the functions that are performed by

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national resolution authorities according to the BRRD. The SRM Regulation came into full effect on 1 January 2016.

The SRB consists of a full-time Chair, four full-time members and one member appointed by each member state participating in the SSM, to represent that member state’s national resolution authority. In December 2015, an agreement between the SRB and the European Parliament came into force, in relation to procedures relating to the accountability of the SRB to the European Parliament. In addition, the SRB and the European Central Bank have concluded a memorandum of understanding relating to co-operation and exchange of information, in their respective roles of Single Resolution Authority and Single Supervisor for the SSM.

The SRM Regulation also established a Single Resolution Fund (“SRF”), with a target size of 1% of the amount of the deposits of all SSM banks that are guaranteed under the Deposit Guarantee Schemes Directive. The initial target date for such a figure to be reached is 1 January 2024. The purpose of the SRF is the same as that of a national resolution fund under the BRRD, namely to support a resolution under the SRM, if necessary by making loans or providing guarantees, purchasing assets and making contributions to a bridge institution or asset management vehicle or paying compensation to shareholders or creditors who end up worse off in the resolution than they would have in an insolvency procedure.

The SRF is funded by contributions from the banking industry, including by ex ante contributions. The implementing Regulation in relation to the SRF, which harmonises the methodologies for raising ex ante contributions with those in the BRRD, became effective from 1 January 2016. A separate delegated Regulation, dealing with the criteria for calculating ex ante contributions and the deferral of ex post contributions to the SRF, was adopted by the European Commission in December 2015. However, the EU Council of Ministers and the European Parliament are yet to consider the delegated Regulation. Assuming they have no objections, it is expected to enter into force in the first half of 2016.

While the SRF is building up its resources, it will require bridge financing, and the EU Council of Ministers in November 2015 published details of the work in progress for an agreement on such bridge financing. It envisaged that it would consist of national credit lines from the participating member states, and these national credit lines are presumably in place, given that the SRF became operational on 1 January 2016.

Looking further into the future, the European Commission is required to publish a report by 31 December 2018, and once every five years thereafter, on the application of the SRM Regulation, dealing with how it is functioning and its cost efficiency, including particularly how effective the co-operation and information sharing arrangements have been between the SRB and the European Central Bank and between the SRB and national resolution authorities and national competent authorities.

XIX. EU Deposit Insurance Regulation

The recast Deposit Guarantee Schemes Directive\(^78\) protects EU deposits up to EUR100,000 through national Deposit Guarantee Schemes (“DGS”) throughout the EU and requires each credit institution authorised in the EU to become a member of its home state’s DGS. The Directive imposes various obligations on the establishment, supervision and operation of DGSs.

In connection with the establishment of the SSM and the SRM, it was originally envisaged by the EU Commission that a single deposit guarantee scheme for member states participating in the SRM/SSM would be one of the main elements of the banking union established thereby. Although these proposals were deferred, in June 2015, in the “Five Presidents” report on completing monetary union within the Eurozone, Jean-Claude Junker, President of the EU Commission, proposed the launch of a European Deposit Insurance Scheme (“EDIS”).

On 24 November 2015, the EU Commission published a draft Regulation to amend the Regulation for the SRM to establish the EDIS. The draft Regulation envisages that the EDIS will be operated by the Single Resolution Board and will provide additional funding for DGSs established in member states participating in the SRM. The draft Regulation envisages EDIS being established in three successive stages:

- Reinsurance – for the first three years, EDIS will reinsure participating DGSs and cover a limited share of the loss of a participating DGS and will provide funding in the event of a liquidity shortfall at a DGS;

- Co-insurance – for four years after the reinsurance period, participating DGSs will be co-insured by the EDIS. The percentage of loss covered by the EDIS under such co-insurance will commence at 20% and rise by 20% each subsequent year; and

- Full insurance – after the co-insurance period, participating DGSs will be fully insured by the EDIS. It is intended that this will occur by 2024.

It is likely that the draft Regulation will continue to be debated during 2016. There is currently no clear timetable for finalisation of the Regulation.

**XX. PSD II**

The Payment Services Directive (“PSD”) became law in most of the EU in 2009 and aimed to harmonise the regulatory regime for payment services across the EU by enabling a new type of regulated financial institution (a “payment institution”) to compete with banks in the provision of payment services. It established an EU-wide licensing regime for payment institutions, as well as harmonised conduct of business rules.

The EU Commission published proposals for an amended payment services Directive in July 2013 and the final approved text of such Directive (referred to as “PSD2”) was published in the Official Journal of the EU on 23 December 2015 and entered into force on 12 January 2016. EU member states are required to transpose PSD2 into national laws by 13 January 2018.

PSD2 makes certain extensions to the geographical scope and the currencies covered by the PSD. The PSD is limited to payment services provided in the EU where both the payer’s and payee’s payment service provider are located in the EU. Under PSD2, certain provisions (primarily in respect of transparency of terms and conditions and information requirements) will apply to transactions where only one of the payment service providers is located in the EU. PSD2 will also now apply the provisions relating to transparency and information requirements to all currencies, not only EU currencies, as is currently the case.

The definition of payment services will also be widened to cover (i) payment initiation services enabling access to a payment account provided by a third-party payment service provider, where the payer can be actively involved in the payment initiation or the third-party payment service provider’s software or where payment instruments can be used by the payer or payee to transmit the payer’s credentials to the account servicing payment service provider and (ii) an account information service where consolidated and user-friendly information is provided to a payment service user on one or several payment accounts held by the payment service user with one or several account servicing payment service providers.

In addition, a number of the existing exemptions available under the PSD are narrowed or removed, and various amendments are made to the conduct of business requirements. The exemptions affected include:

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• the “commercial agent” exemption relating to payment service providers acting as a commercial agent. This exemption will now only apply where the agent is acting solely for either the payer or payee, but not both parties;

• the “limited network” exemption where a payment instruction can only be used to purchase a limited range of goods or services within a limited network of service providers. Under PSD2, any services relying on the exemption must be based on specific instruments designed to address precise needs that can only be used in a limited way. Also, if the monthly volume of transactions exceeds EUR1 million, the payment service provider must obtain clearance from its competent authority to be able to utilise the exemption; and

• the exemption under the PSD for digital content or telecom payments applying to payments executed through mobile phones and the internet is, under PSD2, limited to ancillary payment services carried out by providers of electronic communication networks or services. The exemption is also no longer available for any individual transaction exceeding EUR50 and is subject to an overall limit of EUR300 in a billing month.

A number of other conduct of business requirements are amended by PSD2 and it contains some provisions aimed at increasing competition by facilitating the use of third-party payment service providers (“TPPs”). PSPs will be prohibited from denying TPPs access to bank accounts and PSPs, which provide account servicing cannot discriminate against TPPs.

The PSD2 requires the EBA to develop RTS and/or guidelines in relation to information to be provided to competent authorities in respect of an application for authorisation, the requirements for authentication and communications and the development, operation and maintenance of the electronic central register. These are required to be finalised by 13 January 2017, and consultation drafts are therefore expected to be published by the EBA during 2016.

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