Recent EU regulatory reform and how this impacts Asia-Pacific
June 2015
Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>3</td>
</tr>
<tr>
<td>OTC Derivatives, CCPs and Trade Repositories Regulation (EMIR)</td>
<td>8</td>
</tr>
<tr>
<td>Revised Markets in Financial Instruments Directive and Regulation (MiFID2/MiFIR)</td>
<td>14</td>
</tr>
<tr>
<td>Contractual recognition of resolution powers</td>
<td>21</td>
</tr>
<tr>
<td>Other</td>
<td>31</td>
</tr>
<tr>
<td>Contacts</td>
<td>35</td>
</tr>
</tbody>
</table>

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Introduction

Recent EU regulatory reform and how this impacts Asia-Pacific
How does EU legislation impact Asia-Pacific markets?

**Outbound:** EU banks transact with Asia-Pacific counterparties directly and through Asia-Pacific branches and subsidiaries

**Inbound:** Asia-Pacific entities (incl. Asia-Pacific subsidiaries of EU banks) transact with EU entities

**“True ET”:** Transaction between Asia-Pacific entities that affects EU

Recent EU regulatory reform and how this impacts Asia-Pacific
Drivers of the post-crisis EU agenda

Recent EU regulatory reform and how this impacts Asia-Pacific
## EU post-crisis financial sector legislation

<table>
<thead>
<tr>
<th>Prudential and too-big-to-fail</th>
<th>Adopted &amp; implemented</th>
<th>Adopted &amp; partially implemented</th>
<th>Adopted &amp; implementation starting</th>
<th>Proposed (not yet agreed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Supervisory Authorities/ESRB*</td>
<td>■</td>
<td>CRD/CRR: Basel 3*</td>
<td>Single resolution mechanism (+ IGA)*</td>
<td>Bank structural reform*</td>
</tr>
<tr>
<td>CRD3: remuneration and capital</td>
<td>■</td>
<td>Single Supervisory Mechanism*</td>
<td>Deposit guarantees</td>
<td></td>
</tr>
<tr>
<td>Financial conglomerates</td>
<td>■</td>
<td>Solvency 2: insurers</td>
<td>ESM direct recapitalisation</td>
<td></td>
</tr>
<tr>
<td>Omnibus 2: insurance supervision</td>
<td>■</td>
<td>State aid rules</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>■</td>
<td>Bank recovery and resolution</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Markets and infrastructure</th>
<th>Adopted &amp; implemented</th>
<th>Adopted &amp; partially implemented</th>
<th>Adopted &amp; implementation starting</th>
<th>Proposed (not yet agreed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit rating agencies (1-4)*</td>
<td>■</td>
<td>EMIR: derivatives reform*</td>
<td>MIFID2/MiFIR*</td>
<td>Financial benchmarks*</td>
</tr>
<tr>
<td>Short selling and CDS*</td>
<td>■</td>
<td>Energy market transparency*</td>
<td>Market abuse reform*</td>
<td>Financial transaction tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Transparency obligations</td>
<td>Investor protection schemes</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Central securities depositories*</td>
<td>Shareholders rights</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Securities financing transactions*</td>
<td>Capital markets union</td>
</tr>
<tr>
<td></td>
<td></td>
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<td></td>
<td>CCP resolution</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Investor/ consumer protection</th>
<th>Adopted &amp; implemented</th>
<th>Adopted &amp; partially implemented</th>
<th>Adopted &amp; implementation starting</th>
<th>Proposed (not yet agreed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single European Payment Area (SEPA)*</td>
<td>■</td>
<td>Prospectuses</td>
<td>MIFID2/MiFIR*</td>
<td>Payment services (PSD2)*</td>
</tr>
<tr>
<td></td>
<td>■</td>
<td></td>
<td>Packaged retail investment products*</td>
<td>Insurance mediation</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Mortgage credit</td>
<td></td>
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<td></td>
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<td>Payment accounts</td>
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<td></td>
<td></td>
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<td>4th AML directive</td>
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<td>Fund transfer information*</td>
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<thead>
<tr>
<th>Asset management</th>
<th>Adopted &amp; implemented</th>
<th>Adopted &amp; partially implemented</th>
<th>Adopted &amp; implementation starting</th>
<th>Proposed (not yet agreed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU venture capital funds*</td>
<td>■</td>
<td>Alternative investment fund managers</td>
<td>UCITS 5</td>
<td>Money market funds</td>
</tr>
<tr>
<td>Social entrepreneurship funds*</td>
<td>■</td>
<td></td>
<td>Long-term investment funds*</td>
<td>Pension funds</td>
</tr>
</tbody>
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<tr>
<th>Cross-sectoral</th>
<th>Adopted &amp; implemented</th>
<th>Adopted &amp; partially implemented</th>
<th>Adopted &amp; implementation starting</th>
<th>Proposed (not yet agreed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business register interconnection</td>
<td>■</td>
<td>Accounting directive</td>
<td>Corporate non-financial reporting</td>
<td>Data protection*</td>
</tr>
<tr>
<td></td>
<td>■</td>
<td>Audit sector reform*</td>
<td></td>
<td>Cyber-security</td>
</tr>
</tbody>
</table>

*Red denotes significant impact outside the EU. *Includes Level 1 Regulation
Equivalence assessments

Legislation may provide for EU rules not to apply if non-EU rules apply and the Commission has determined that the relevant non-EU regime is equivalent to EU rules.

May include reciprocity requirements e.g. a requirement that the non-EU regime has an effective equivalent mechanism under which EU firms could be exempted from local rules.

Equivalence exceptions raise a range of issues:

1. **Timing:** The EU rules may apply before the non-EU state has adopted equivalent rules or brought them into force.

2. **Scope:** The non-EU rules may not be equivalent because they have a more limited scope than the corresponding EU rules.

3. **Content:** The assessment could involve strict “line by line” equivalence tests or evaluate whether the non-EU rules reach a similar outcome by different means.

4. **Legally binding rules:** In some cases, the non-EU regime may achieve the same objective but without using legally binding rules.

5. **Reciprocity:** Effective reciprocity requirements may be an obstacle to a positive determination.

6. **Ongoing review:** The existence of an equivalence determination may effectively constrain the ability of local regulators to change their rules without EU approval.

Recent EU regulatory reform and how this impacts Asia-Pacific
Recent EU regulatory reform and how this impacts Asia-Pacific
## EMIR – Impact on Asia-Pacific counterparties

### Clearing
- Application to a non-EU entity that would have been an FC or NFC+ if established in the EU

### Risk mitigation
- Application of margin to transactions with non-EU entities

### Reporting
- Reporting counterparties’ potential conflicts with local privacy or secrecy laws

### Branches
- Non-EU branches of EU entities
- EU branches of non-EU entities

### Application to non-EU funds

### Transactions between two non-EU entities

**Note:** Ongoing issues of counterparty classification of non-EU counterparties

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Recent EU regulatory reform and how this impacts Asia-Pacific

Note: Assumes: (i) the Commission adopts the draft RTS on IRS without further amendment in the summer of 2015, the Parliament and the Council confirm that they do not object and the RTS are published in the OJ and come into force in October 2015; (ii) the Council and the Parliament do not object to the Commission’s delegated acts extending the Article 89(1) EMIR transitional period for pension schemes for a further two years until 16 August 2017; and (iii) the final RTS on margin for uncleared trades follow the implementation timetable set out in the BCBS-IOSCO March 2015 revised framework.
ESMA has proposed mandatory clearing for certain classes of IRS and CDS. It does not propose, at this stage, to mandate clearing of FX NDFs, interest rate futures and options, equity products or single name credit products.

The development of RTS on the clearing obligation for IRS is the most advanced. ESMA has delivered its opinion on the Commission’s proposed amended draft RTS. The amended draft RTS envisage the following phase-in of the clearing obligation and application of the frontloading obligation.

**Phase-in of the clearing mandate**

**Phase-in of the clearing obligation**

The amended draft RTS would apply the clearing obligation subject to a phase-in, based upon the categories of counterparties:

- **6 month phase-in period for Category 1 counterparties**: counterparties which, on the date of entry into force of the RTS, are clearing members for at least one of the classes of OTC derivatives listed in Annex 1 of the RTS, or at least one of the CCPs authorised before that date to clear at least one of the classes of OTC derivatives listed in Annex 1 of the RTS.

- **12 month phase-in period for Category 2 counterparties**: FCs and NFC+ AIFs which are not included in Category 1 which belong to a group whose aggregate month-end average notional amount of non-centrally cleared derivatives for [3 months following publication of the RTS in the OJ, excluding the month of publication] is above €8 billion.

- **18 month phase-in period for Category 3 counterparties**: FCs and NFC+ AIFs which are not included in Category 1 or 2.

- **3 year phase-in period for Category 4 counterparties**: NFC+ not included in Category 1, 2 or 3.

The longest phase-in period will apply where the counterparties to a contract fall into different categories.

**Application of the frontloading obligation**

The amended draft RTS provide for a more limited application of the frontloading obligation than envisaged in Art. 4(1)(b)(ii) of EMIR:

- **No frontloading for NFC+**: contracts where at least one counterparty is an NFC+ (in any Category) are not subject to frontloading.

- **No frontloading for Category 3**: the minimum remaining maturity (MRM) for contracts entered into with Category 3 counterparties has been set at the maximum maturity of each class subject to the clearing obligation.

- **Frontloading applies for Category 1 and Category 2**:
  - The frontloading period for FCs in Category 1 begins two months after the RTS enter into force and begins for FCs in Category 2 five months after the RTS enter into force.
  - Contracts entered into or novated after the relevant start date and before the end of the relevant phase-in period will be subject to frontloading if they have a MRM higher than 6 months at the end of the phase-in period.
Phase-in of margin requirements

The ESAs have now issued their second consultation on proposals for draft RTS for the margining of uncleared OTC derivatives broadly in line with the revised policy framework published by BCBS-IOSCO in March 2015.

Variation margin (VM)
- Requirement to collect VM applies from 1 September 2016 (for counterparties over the €3 trillion IM trigger level) and from 1 March 2017 (for all other counterparties).
- Zero threshold for transfer of VM.*

Initial margin (IM)
- Requirement to collect IM phased in from 1 September 2016.
- IM must be collected on gross basis and segregated (without rehypothecation).
- Counterparties may agree a margin threshold of €50m covering all IM to be exchanged between consolidated groups.*
- Counterparties not required to collect IM for physically settled foreign exchange forwards/swaps (or exchange of principal on currency swaps).

Scope
- Requirements to collect margin apply to FCs and NFC+s and they are not required to collect VM or IM from NFCs under EMIR clearing threshold.
- FCs/NFC+s would be required to collect VM and IM from, and to post VM and IM to, non-EU counterparties where the non-EU counterparty would be subject to the margin rules if established in the EU.

Rules apply prospectively
- Margin requirements apply to new transactions entered into after the specified dates.

Phase-in timetable for initial margin

<table>
<thead>
<tr>
<th>From 1 September:</th>
<th>Trigger level for consolidated groups:</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>€3 trillion</td>
</tr>
<tr>
<td>2017</td>
<td>€2.25 trillion</td>
</tr>
<tr>
<td>2018</td>
<td>€1.5 trillion</td>
</tr>
<tr>
<td>2019</td>
<td>€0.75 trillion</td>
</tr>
<tr>
<td>2020 onwards</td>
<td>€8 billion</td>
</tr>
</tbody>
</table>

Notes:
A counterparty is required to collect initial margin where both counterparties belong to consolidated groups having total gross notional values of uncleared OTC derivatives (including foreign exchange forwards/swaps) over the trigger level (based on average notional amounts for March, April and May before 1 September of the year in question).

*Counterparties may agree a minimum transfer amount of €500,000 covering all VM and IM.
Equivalence assessments under EMIR

Non-EU CCPs

- Equivalence assessments, regulatory co-operation agreements and recognition decisions under Art. 25 EMIR are in place for Australia, Hong Kong, Japan, Singapore (will also trigger ESMA review of possible clearing mandate for OTC products)
- Other applications pending include CCPs from India, Korea, Malaysia, New Zealand, Taiwan (but not PRC) – reciprocity issues?
- Transitional treatment of applicant CCPs as QCCPs under CRR extended to 15 December 2015 (may be extended for further 6 months)
- Impact on EU banks/groups if QCCP treatment not extended
- Issues for new Asia-Pacific CCP initiatives not benefiting from transitional relief

Transactional rules of non-EU states

- Art. 13 EMIR provides for equivalence assessments of non-EU states’ clearing, reporting and risk mitigation rules and relief for counterparties from EU rules where one party is located in equivalent non-EU state
- Intragroup exemption from clearing and margin rules also only available for transactions between EU and non-EU group member if non-EU state is assessed equivalent under Art. 13
- Possible substantial delay in making any assessments under Art. 13

Extension of EMIR exemptions to Asia-Pacific central banks likely to depend on equivalent treatment of EU central banks under local law
Recent EU regulatory reform and how this impacts Asia-Pacific

MiFID2/MiFIR
## MiFID2 and MiFIR: key elements of the reforms

### Market structure
- Introduction of a new multilateral, discretionary trading venue, the Organised Trading Facility (OTF), for non-equity instruments.
- Expanded scope of Systematic Internaliser (SI) category with increased transparency requirements.
- Requirement for investment firms to trade listed equities on a Regulated Market (RM), Multilateral Trading Facility (MTF) or SI and effective limitation of “pure” over the counter business for cash equities.
- New systems and controls requirements for organised trading venues.
- Introduction of trading controls for algorithmic trading activities.
- Obligation to trade clearable derivatives on organised trading platforms.
- Introduction of a harmonised EU regime for non-discriminatory access to trading venues, CCPs and benchmarks.

### Transparency and transaction reporting
- Equity market transparency to be increased.
- New transparency requirements for fixed income instruments and derivatives with scope of requirements calibrated for liquidity.
- “Consolidated Tape” for trade data. Requirement to submit post-trade data and transaction reports to authorised providers.
- Widening scope of MiFID transaction reporting obligations.

### Conduct, supervision and product scope
- Increased conduct of business requirements to improve investor protection.
- Regulatory perimeter extended to cover structured deposits.
- Strengthened supervisory powers with new powers to ban products or services that threaten investor protection, financial stability or the orderly functioning of markets.
- Strengthened administrative sanctions to ensure effectiveness and harmonisation.

### Commodities
- Change in scope of regulatory perimeter for commodities business.
- Introduction of a harmonised position limits regime for commodity derivatives to improve transparency, support orderly pricing and prevent market abuse.

### Third countries
- Limited attempt to harmonise regime for access to EU markets by third country firms.
MiFID2 and MiFIR: expected timeline

30 months

<table>
<thead>
<tr>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1</td>
<td>Q2</td>
<td>Q3</td>
<td>Q4</td>
</tr>
<tr>
<td>Level 1 and national transposition</td>
<td>Published in Official Journal and in force (2 July 2014)</td>
<td>Consultations on national implementation</td>
<td>National transposition (by 3 July 2016)</td>
</tr>
<tr>
<td>Consultation/adoption of Level 2 measures</td>
<td>ESMA advice to Commission (by 3 January 2015)</td>
<td>ESMA draft RTS to Commission (by end Sept 2015)</td>
<td>ESMA draft ITS to Commission (by 3 January 2016)</td>
</tr>
<tr>
<td>ESMA/Commission consultations on Level 2 measures</td>
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Notes:
- Very limited transitional provisions
- The Commission/ESMA may develop FAQs and guidelines
- Market Abuse Regulation starts to apply from 3 July 2016
- ESMA will likely also consult on RTS on OTC derivative trading mandate before new rules begin to apply
- Equivalence assessments required for third countries
Outbound business of EU firms
New issues for EU entities serving non-EU clients

New rules apply to business booked in EU - even if clients are outside EU

- New trading and transparency regime will apply to many non-EU instruments
  - If those instruments traded on EU venues e.g. Börse Berlin trades 15,000 shares from 82 countries
  - Restriction on trading shares outside an EU venue
  - SI pre-trade transparency rules – IBIA v COFIA
  - Post-trade transparency – competitive disparity
  - Trading restriction for liquid cleared OTC derivatives

- New conduct of business rules for non-EU clients
  - Reporting transactions and commodity derivative positions for non-EU clients
  - Challenges in re-papering non-EU clients

Unclear how new regime will apply to business in non-EU branches

- Conflicting Commission statements on application of MiFID1 in non-EU branches
- Current UK approach to applying MiFID1 rules in non-EU branches
  - Conduct rules: No (with exceptions)
  - Client assets: No
  - Common platform rules: No (exc. In prudential context)
  - MTF operation: Yes
  - Post-trade transparency: No
  - Transaction reporting: ?

- New derivatives trading and new transaction reporting obligations likely to apply to non-EU branches
- Potential for wider regime shift?

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Inbound business of non-EU firms

The “patchwork” continues

Cross-border business with per se professionals and eligible counterparties

Can continue on basis of national rules

- Until 3 years after an equivalence decision for the relevant jurisdiction
- Liberal rules in UK, Belgium, Ireland, Lux. can continue
- But restrictive regimes in other Member States also continue to apply

If there is an equivalence decision for a non-EU state:

- Authorised firms from that state will have to register with ESMA
- But will be able to continue to do business subject to limited EU rules (status disclosure, submission to jurisdiction)

Will there be any equivalence decisions (requires equivalence plus reciprocity)?

Cross-border business with retail clients and EU branches of non-EU firms

Member states will have to choose whether to impose a branch requirement

- Many member states already restrict this business

If the UK chose this option (unlikely), could impact non-EU firms:

- Relying on exemptions to do cross-border retail business (e.g. formerly overseas client exemptions)
- Authorised under FSMA without a branch in UK
- Doing MiFID2 business through an existing UK branch because of new requirements for:
  - Cooperation agreement with home state regulator
  - Qualifying tax information exchange treaty
  - Initial capital in the branch
- But branches could benefit from a “passport” for cross-border wholesale business in the EU if there was ever an equivalence decision on its home state
Other extraterritorial impacts of new regime

### Indirect clearing rules for non-EU ETDs
- Indirect clearing esp. important for EU firms’ access to non-EU exchanges
- New rules will apply to ETD traded on trading venues in “equivalent” non-EU states
- New rules could operate as effective ban on indirect clearing

### Worldwide position limit regime
- Applies to any person trading commodity derivative contract traded on an EU venue and any OTC contract economically equivalent to such a contract
- Identifying relevant EU traded contracts and determining equivalence

### Trading mandate for TCE-TCE trades in OTC derivatives
- Third country entities (TCEs) trading with each other subject to trading mandate for OTC derivatives
- Similar circumstances (and complexities) as clearing mandate for TCE-TCE trades under EMIR

### New product intervention powers
- Unprecedented powers for national regulators (and ESMA) to ban products and practices
- Likely to affect cross-border activity into the EU
- With potential spillovers to non-EU activity (c.f. UK ban on marketing CoCos)

Plus: for inbound business, assisting EU counterparties with their compliance (e.g. new research rules)
# Limited relief through third country equivalence assessments

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<thead>
<tr>
<th>Equivalent third country regulated markets (securities)</th>
<th>Relevant of equivalence assessment</th>
<th>Comment</th>
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<tbody>
<tr>
<td>Investment firms may satisfy mandatory trading requirement for shares by execution on these markets (Article 23(1) MiFIR).</td>
<td></td>
<td>Under Article 25(4)(a) MiFID2, a third country market is considered equivalent to a regulated market for these purposes† if it is considered equivalent to a regulated market for the purposes of the rules on offers of securities to employees under Article 4(1) of Prospectus Directive. A competent authority must request an equivalence determination by Commission with respect to the third country (but no determinations have yet been made).</td>
</tr>
<tr>
<td>Appropriateness requirements are waived for execution-only transactions in certain shares and bonds admitted to trading on these markets (Article 25(4)(a)(i) and (ii) MiFID2).</td>
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<tr>
<td>Equivalent third country trading venues (OTC derivatives)*</td>
<td>Counterparties may satisfy mandatory trading requirement for OTC derivatives by execution on venues established in an equivalent third country (Article 28(1)(d) MiFIR).</td>
<td>Commission determines equivalence of third country regime under Article 28(4) MiFIR. ‡</td>
</tr>
<tr>
<td>Equivalent third country regulated markets (ETD)</td>
<td>Rules on indirect clearing under Article 30 MiFIR apply to ETD, which includes derivatives executed on third country venues equivalent to regulated markets.</td>
<td>Article 2(1)(32) MiFIR defines ETD to include derivatives traded on a third country market considered equivalent to a regulated market under Article 28 MiFIR (see above).</td>
</tr>
<tr>
<td>Duplicative and conflicting rules (derivatives)</td>
<td>Deemed compliance with rules on execution and clearing of derivatives in Articles 28 and 29 MiFIR where one counterparty is established in an equivalent third country and counterparties comply with rules in that country (Article 33 MiFIR).</td>
<td>Commission determines equivalence of third country regime under Article 33(2) MiFIR. Third country rules must be effectively applied and enforced in an equitable and non-distortive manner. Commission (with ESMA) must monitor third country rules and report annually to European Parliament and the Council.</td>
</tr>
<tr>
<td>Access rights for third country CCPs and trading venues*</td>
<td>Third country trading venues and CCPs have rights of access to EU CCPs, trading venues and benchmarks if they are established in equivalent third countries (Article 38 MiFIR).</td>
<td>Commission determines equivalence of third country regime under Article 38(3) MiFIR. Third country trading venues may only request access to CCPs if equivalent under Article 28 MiFIR and third country CCPs may only request access to EU trading venues if recognised under EMIR (Article 38(1) MiFIR).</td>
</tr>
<tr>
<td>Cross-border services*</td>
<td>Third country firms from equivalent jurisdictions must register with ESMA to provide cross-border services to eligible counterparties and per se professional clients on the basis of their home state rules (Article 46 MiFIR).</td>
<td>Commission determines equivalence of third country regime under Article 47(1) MiFIR. Firm must be authorised in the third country and additional criteria must also be satisfied under Article 46, including the existence of cooperation arrangements with ESMA.</td>
</tr>
</tbody>
</table>

- A reciprocity requirement applies, i.e. there must be an effective equivalent system for recognising or giving access to EU firms.
- † When MiFID2 applies, a contract will also not be an OTC derivative contract under Article 2(7) EMIR if it is executed on a regulated market or a third country market considered to be equivalent to a regulated market under Article 25(4)(a) MiFID2 (not Article 28 MiFIR – contrast the definition of ETD in MiFIR).
- ‡ The exemption from the mandatory trading requirement for intragroup transactions involving third countries depends on an equivalence assessment under EMIR.
Contractual recognition of resolution powers
What do contractual recognition clauses cover?

<table>
<thead>
<tr>
<th>Recognition of:</th>
<th>In contracts entered into by:</th>
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<tbody>
<tr>
<td></td>
<td>EU resolution entity</td>
</tr>
<tr>
<td>Bail-in power</td>
<td>✓ Art 55 / Art 45(5) BRRD</td>
</tr>
<tr>
<td></td>
<td>All contracts (subject to limited exclusions)/liabilities qualifying as MREL</td>
</tr>
<tr>
<td>Stays:</td>
<td>✓ ISDA Protocol PRA proposed rule s.60a SAG</td>
</tr>
<tr>
<td>Transfer power</td>
<td>✓ ISDA Protocol Protocol Covered Agreements</td>
</tr>
</tbody>
</table>
Article 55 BRRD

**Purpose**
- Ensure that resolution authorities have power to bail-in all liabilities of in-scope entity, including those governed by a non-EU law

**Requirement**
- Applies to *all* contracts entered into by in-scope entities creating any liability:
  - If governed by the law of a non-EU state
  - Unless the liability is an excluded liability
- Contract must contain a term recognising that liability is subject to bail-in powers and agreeing to be bound by any resulting reduction/cancellation/conversion of the claim
- Except if resolution authority determines that bail-in can be given effect under the foreign law or a binding agreement with non-EU state
- Resolution authority may require legal opinion
- MREL eligible liabilities require effective term

**Entity scope**
- EU banks and qualifying investment firms
- EU holding companies of those banks/firms
- EU financial institution subsidiaries of the above
- (May be affected by national implementation)

**Timing:**
- **BRRD**: EU Member States must bring rules into force on 1 January 2015 but can delay application of Art. 55 till 1 January 2016
- **UK**: From 19 February 2015, PRA rules apply Art. 55 to unsecured debt instruments issued by UK in-scope entities
  - From 1 January 2016, PRA/FCA rules apply Art. 55 to all relevant contracts of UK in-scope entities
- **Grandfathering**: liabilities issued/entered into before Member State applies its implementing requirements
Excluded liabilities

- **EU insured deposits (up to level of cover)**
- **Deposits by individuals and SMEs with EU or non-EU branches of EU banks**
- **Secured liabilities, including covered bonds (to the extent of the security)**
- **Liabilities from holding client assets or client money (if protected under insolvency law)**
- **Liabilities arising as a fiduciary (if protected under insolvency law)**
- **Liabilities to “institutions” (non-group) with original maturity < 7 days**
- **EU systems designated under Settlement Finality Directive: liabilities to operator and participants with remaining maturity < 7 days**

**Liabilities to:**
- Employees: accrued salary, pension benefits (but not variable remuneration)
- Tax and social security authorities (if preferred under local law)
- Commercial or trade creditor for goods or services critical to daily functioning of its operations, incl. IT, real estate
- Contributions due to EU deposit guarantee schemes

Note: EBA draft RTS specifying the content of the required contractual term and the extent of exclusions
EBA draft RTS on contractual recognition clauses

**Liabilities to which the exclusion applies**

- Clarifies application to unsecured liabilities
  - Exclusion does NOT apply to any unsecured portion of a liability, or where a liability may become unsecured
- Clarifies application to existing liabilities
  - Exclusion does NOT apply to new liabilities creating under existing agreements, amendments to existing agreements, debt instruments issued under existing programmes
- Indicates key elements of third country law that should be present before resolution authorities can determine that liabilities may be written down

**Form of contractual term**

- Not a template clause
- Must identify each relevant resolution authority and relevant legislation governing write-down and conversion powers
- Must specify write-down and conversion powers of each relevant resolution authority
- Must include express acknowledgement, agreement and consent of counterparty that:
  - The liability may be subject to write-down and conversion powers;
  - The counterparty is bound by any reduction or conversion;
  - The terms of the agreement may be varied as necessary to give effect to write-down and conversion powers
  - The counterparty will accept ordinary shares or other ownership rights in lieu of rights under the agreement
  - The contractual term constitutes the entire agreement between the parties on the matters described therein

**Consultation on RTS:** EBA published draft RTS on contractual recognition clauses under Art 55 in November 2015. Consultation closed on 5 Feb 2015

**Final draft RTS:** EBA required to submit draft RTS to the Commission by 3 July 2015
PRA consultation on contractual stay provisions

What is the purpose of these draft rules?

- Prohibits BRRD undertakings creating / materially amending an obligation under a financial arrangement governed by the law of a third country unless the counterparty has agreed in writing only to exercise termination rights to the extent it would be entitled to do so under the SRR
- Intended to support the ISDA Resolution Stay Protocol and similar industry initiatives
- Part of co-ordinated effort between regulatory and resolution authorities in UK, France, Germany, Japan, Switzerland and US

Who would be subject to these rules?

- BRRD undertakings that are (a) a CRR firm; (b) a financial holding company or (c) a mixed financial holding company (UK entities)
- BRRD undertakings that are parent undertakings must ensure that subsidiary credit institutions, investment firms and financial institutions also comply

The PRA published its consultation paper and draft rules on 26 May 2015. The consultation closes on 26 August 2015. Rules will be phased in by counterparty type from 1 January 2016

Which contracts are in scope?

- “Financial arrangements”, including:
  - Financial contracts as defined in Art 2(1)(100)(a) – (d) BRRD
  - Derivatives as defined in EMIR
  - Master agreements relating to financial contracts, derivatives or contracts for the sale, purchase or delivery of currency
- Governed by the law of a third country

Limited exclusions

- Contracts with designated systems, CCPs (authorised or recognised under EMIR), clearing houses, central banks and central governments are out of scope
German draft law on contractual stay provisions (s.60a SAG)

What is the purpose of the draft law?

- **Institutions and group entities** must include contractual provisions in any relevant **financial contract** by which the counterparty recognises that there may be a temporary suspension of termination rights and other contractual rights, and agrees to any such suspension.

- Intended to support the ISDA Resolution Stay Protocol and similar industry initiatives.

The German Federal Government proposed a draft law in May 2015 on the requirement to recognise temporary stays on termination of financial contracts. This follows an earlier draft in March 2015.

Applies from 1 Jan 2016 (no phase-in)

Which contracts are in scope?

- Financial contracts (as defined in Art 2(1)(100) BRRD) governed by the law of or subject to the jurisdiction of a third country.

- Governed by the law of or subject to the jurisdiction of a third country.

Limited exclusions

- The obligation does not apply to:
  - Obligations created before 1 January 2016 unless the obligation is part of a netting arrangement;
  - Financial contracts or master agreements entered into by or with participants named in s.84(4) SAG, system operators, central counterparties and central banks.

Who would be subject to the draft law?

- Institutions and group entities (German entities)

- Parent undertakings must procure that their consolidated subsidiaries incorporated outside of Germany also comply with these requirements.

Recent EU regulatory reform and how this impacts Asia-Pacific
BRRD definition of ‘financial contracts’ includes …

<table>
<thead>
<tr>
<th>Securities contracts</th>
<th>Contracts for purchase, sale or loan</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Options</td>
</tr>
<tr>
<td></td>
<td>Repurchase or reverse repurchase transactions</td>
</tr>
<tr>
<td></td>
<td>Relating to a security, a group or index of securities</td>
</tr>
<tr>
<td>Commodities contracts</td>
<td>Contracts for purchase, sale or loan</td>
</tr>
<tr>
<td></td>
<td>Options</td>
</tr>
<tr>
<td></td>
<td>Repurchase or reverse repurchase transactions</td>
</tr>
<tr>
<td></td>
<td>Relating to a commodity or group or index of commodities</td>
</tr>
<tr>
<td>Futures and forwards</td>
<td>Contracts for purchase, sale or transfer</td>
</tr>
<tr>
<td></td>
<td>Relating to a commodity or property of any description, service right or interest</td>
</tr>
<tr>
<td></td>
<td>For a specified price at a specified future date</td>
</tr>
<tr>
<td>Swap agreements</td>
<td>Swaps and options relating to interest rates, spot or other FX agreements, currency, an equity index or equity, a debt index or debt, commodity, weather, emissions or inflation</td>
</tr>
<tr>
<td></td>
<td>Total return, credit spread, or credit swaps</td>
</tr>
<tr>
<td></td>
<td>Similar agreements the subject of recurrent dealings in the swaps or derivatives markets</td>
</tr>
<tr>
<td>Short-term interbank borrowings</td>
<td>Interbank borrowing agreements where the term of the agreement is 3 months or less</td>
</tr>
<tr>
<td>Master agreements</td>
<td>Relating to any of the above</td>
</tr>
</tbody>
</table>
## Contractual recognition of resolution powers (1)

<table>
<thead>
<tr>
<th>In-scope contracts:</th>
<th>Article 55 BRRD (and draft EBA RTS)</th>
<th>UK PRA CP19/15</th>
<th>Germany: proposed Section 60a SAG</th>
<th>ISDA Resolution Protocol</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Contracts of particular class?</strong></td>
<td>All contracts (subject to exclusions)</td>
<td>Financial contracts (exc. short term borrowings), derivatives covered by EMIR and master agreements related thereto or to sale, purchase or delivery of UK or other currency</td>
<td>Financial contracts</td>
<td>ISDA master agreements</td>
</tr>
<tr>
<td><strong>If governed by non-EU law?</strong></td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (or if subject to non-EU jurisdiction)</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>If new (prospective application)?</strong></td>
<td>Partially retroactive (if new liabilities under or amendment of existing contract)</td>
<td>Partially retroactive (if new obligation under or material amendment of existing contract)</td>
<td>Partially retroactive (for netting agreements)</td>
<td>Retroactive to cover all transactions under covered agreements</td>
</tr>
<tr>
<td><strong>Any exempt counterparties?</strong></td>
<td>No (but see exclusions)</td>
<td>Designated systems, CCPS (authorised or recognised under EMIR), clearing houses, central banks and central governments</td>
<td>Participants names in s.84(4) SAG, system operators, CCPs and central banks</td>
<td>N/A</td>
</tr>
</tbody>
</table>

---

1. Must apply in full from 1 Jan. 2016.
4. In scope entities. EU institutions, their EU holding companies and their respective EU financial institution subsidiaries.
5. UK institutions and their UK parent financial and mixed financial holding companies.
6. German institutions and German group entities.
7. Adhering counterparties.
8. Required to ensure compliance by subsidiaries?
9. Yes (UK and non-UK credit institutions, investment firms and financial institutions).
10. Yes (non-German subsidiaries included in consolidation).
11. No (but see exclusions).
12. Participants names in s.84(4) SAG, system operators, CCPs and central banks.
## Contractual recognition of resolution powers (2)

<table>
<thead>
<tr>
<th>Article 55 BRRD (and draft EBA RTS)</th>
<th>UK PRA CP19/15</th>
<th>Germany: proposed Section 60a SAG</th>
<th>ISDA Resolution Protocol</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exempt if local recognition regime?</strong></td>
<td>Yes⁵</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Provides for contractual recognition of:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Bail-in and write down powers (Arts. 43, 59 BRRD)</strong></td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Restriction of termination and enforcement rights (Arts 68, 69, 70, 71 BRRD)⁶</strong></td>
<td>No</td>
<td>Yes⁷</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Powers to transfer contracts (Arts. 38, 41, 42 BRRD)</strong></td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

1. The UK PRA rules apply these requirements from 19 February 2015 to unsecured debt instruments. In Germany, these requirements apply from 1 January 2015. However, a pre-existing contract may need to include contractual recognition clauses if the liability is to qualify towards MREL under Art. 45(5) BRRD.
2. The obligation does not apply to consolidated undertakings of a mixed financial group other than institutions.
3. Financial contracts definitions based on Article 4(1)(100) BRRD covering securities contracts, commodities contracts, futures and forwards, swaps, inter-bank borrowings for less than 3 months and related master agreements.
4. The proposed PRA rules specifically recognise that contracts governed by the law of any EEA state are also out of scope.
5. But if the recognition regime only applies at the discretion of a local regulator, the contract may need to include contractual recognition clauses if the liability is to qualify towards MREL under Art. 45(5) BRRD.
6. Including termination and enforcement rights against subsidiaries of an entity in resolution arising e.g. under cross-defaults.
7. Does not specifically apply to enforcement of security. Does not override termination rights triggered by crisis prevention measures other than the write down of capital instruments.
Other

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Recent EU regulatory reform and how this impacts Asia-Pacific

**Bank Structural Reform Regulation (proposed)**
- Applies to large EU banks/groups, incl. non-EU branches and subsidiaries
- Restrictions on proprietary trading and investment in alternative investment funds which may apply group wide
- Possible requirement for core credit institutions to separate activities

**Benchmark Regulation (proposed)**
- Requirement for EU administrators of benchmarks to be authorised/registered
- Restriction on EU regulated firms using benchmarks not produced by authorised/registered administrator
- Limited ability to use non-EU benchmarks where equivalence determination, endorsement by EU affiliate, recognition of non-EU administrator in EU (and compliance with EU rules)
Recent EU regulatory reform and how this impacts Asia-Pacific

Sea of Change
Regulatory reforms – charting a new course

SFT Regulation (agreed)
- New reporting requirements for securities and commodity financing transactions (SFTs)
- Repos and loans and possibly total rate of return swaps and margin loans
- Additional disclosure requirements for funds
- Transparency and consent requirements for reuse of collateral

Market Abuse Regulation (adopted)
- Wider prohibitions on insider dealing and market manipulation
- Broader extraterritorial and product reach
- Additional conduct requirements e.g. rules on market soundings
- Applies from 3 July 2016
Are we nearly there yet?

Bank capital
- Basel 4: simplification and stress testing
- Gone concern loss absorbing capital
- Disclosure

Bank structure
- Volcker v Barnier
- Funds and securitisation
- Balkanisation in global markets
- Regulation of branches
- Impact of resolution planning

Financial infrastructure
- Resolution of critical infrastructure
- Operational risk
- Competition issues, access
- Cross-border legal issues

Shadow banking
- Fixing securitisation
- Asset managers as SIFIs
- Other non-bank intermediaries
- Margin for securities financing

Data
- Regulatory transparency
- Reporting infrastructure and compliance
- Cyber security

Markets
- Capital markets union
- Conduct issues and enforcement
- Future of retail savings
- National initiatives e.g. fair and effective markets review

Growth and jobs
- Alternative finance
- Marketplace lending and investing
- Facilitating credit for SMEs

Plus:
- Greek crisis
- UK EU referendum

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