WHITE & CASE

Insight: Capital Markets

June 2013

Financial Regulatory Update

This newsletter provides an overview of some of the main financial services regulatory developments in the UK and EU from the period 1 January 2013 to 1 June 2013. For a copy of our last newsletter, click here.

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Banking and Prudential Supervision

Basel 3/Capital Requirements Directive

Capital Requirements Directive and Regulation (CRD IV)

On 16 April, the European Parliament adopted the legislative package known as CRD IV. CRD IV consists of:

- a Directive on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms; and
- a Regulation containing detailed prudential requirements for credit institutions and investment firms.

The final text remains subject to a detailed review of legal drafting and translation into other official EU languages and formal adoption by ministers. On the basis that translation will be completed in time for the legislation to be published in the EU's Official Journal by 1 July 2013, implementation of CRD IV will be from 1 January 2014. If it is published after 1 July 2013, implementation is expected to take place from 1 July 2014.

CRD IV implements, or provides for the implementation of, international Basel 3 capital and liquidity standards in the EU. CRD IV also contains requirements that go beyond the Basel 3 standards, including in relation to remuneration.

Consultation on the definition of 'Material Risk Takers' under CRD IV, for remuneration purposes

On 21 May 2013, the European Banking Authority (**EBA**) launched a consultation paper on draft technical standards for the definition of 'material risk takers' for remuneration purposes under CRD IV.

This paper, which can be accessed by clicking here, contains draft Regulatory Technical Standards (**RTS**) on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile. These material risk takers will be subject to specific provisions of CRD IV related, in particular, to the payment of bonuses. The proposed definitions extend the category of material risk takers under the UK's current rules.

Staff are to be identified as material risk takers if they meet one or more of the following criteria:

- **Standard qualitative criteria:** related to the role and decision-making power of staff members (e.g. is the member of staff a member of a management body, a senior manager, or does he/she have the authority to commit significantly to credit risk exposures?)
- **Standard quantitative criteria:** related to the level of variable or total gross remuneration in absolute or in relative terms. In this respect, staff should be identified as material risk takers if:
  - (a) their total remuneration exceeds, in absolute terms, EUR 500 000 per year;
  - (b) they are included in the 0.3% of staff with the highest remuneration in the institution;
  - (c) their remuneration bracket is equal to, or greater than, the lowest total remuneration of senior management and other risk takers; or
  - (d) their variable remuneration exceeds EUR 75 000 and 75% of the fixed component of remuneration.
- **Internal criteria:** the criteria are to be based on internal risk assessment processes, reflecting the specific institution's risk profile.

The consultation runs until 21 August 2013.

Basel 3

Liquidity Coverage Ratio

In January 2013, the Bank for International Settlements Basel Committee on Banking Supervision (**Basel Committee**) issued the full text of the revised Liquidity Coverage Ratio (**LCR**) following approval by its governing body.

The revisions to the LCR incorporate amendments to the definition of high-quality liquid assets (**HQLA**) and net cash outflows. The Basel Committee has also agreed a revised timetable for the phase-in of the standard and additional text to give effect to the Committee's intention for the stock of liquid assets to be used in times of stress. The changes to the definition of the LCR include an expansion in the range of assets eligible as HQLA and some refinements to the assumed inflow and outflow rates to better reflect actual experience in times of stress. Once the LCR has been fully implemented, its 100% threshold will be a minimum requirement in normal times. During a period of stress, banks would be expected to use their pool of liquid assets, thereby temporarily falling below the minimum requirement.

The LCR will be subject to phase-in arrangements which align with those that apply to the Basel 3 capital adequacy requirements. More specifically, the LCR will be introduced on 1 January 2015, but the minimum requirement will begin at 60%, rising in equal annual steps of 10 percentage points to reach 100% on 1 January 2019.

For a copy of the revised LCR and a summary description of the LCR, click here and here.

Basel 3 Progress Report

In April 2013, the Basel Committee produced a Report to G20 Finance Ministers and Central Bank Governors on the implementation of Basel 3 regulatory reform. For a copy of the report, click here.

Banking Union in the EU

Single Supervisory Mechanism

Progress has been made on the first pillar of banking union in the EU, namely the adoption of a single supervisory mechanism (**SSM**) for Eurozone banks, with the European Parliament and Council reaching political agreement on the proposal in March 2013. The European Parliament is currently set to consider the SSM proposal formally in September.

The SSM is currently anticipated to become effective in March 2014, with, initially, approximately 30 of the Eurozone's largest banks being directly regulated by the European Central Bank (**ECB**). Transitional arrangements are expected. Non-eurozone banks can opt into the mechanism. Establishment and operation of the SSM is one of the pre-conditions for direct recapitalisation by the European Stability Mechanism (**ESM**).

The SSM places the ECB at the heart of the Eurozone bank regulatory system, with the main features of the proposed system as follows:

- The ECB will assume key supervisory tasks and powers over all the credit institutions established within the euro area. The ECB will perform its tasks within a SSM composed of the ECB and national competent authorities.
- Within the SSM, the ECB will be responsible for the supervision of all 6,000 banks in the euro area:
  - ensuring the coherent and consistent application of the single rulebook in the euro area;
  - directly supervising banks having assets of more than EUR 30 billion or constituting at least 20% of their home country's GDP or which have requested or received direct public financial assistance from the European Financial Stability Facility (EFSF) or the ESM; and
  - monitoring the supervision by national supervisors of less significant banks. The ECB may choose to supervise one or more of these credit institutions directly.
- For cross-border banks active both within and outside Member States participating in the SSM, existing home/host supervisor coordination procedures will continue to exist as at present. If the ECB has taken over direct supervisory tasks, it will carry out the functions of the home and host authority for all participating Member States.
- The rules on the functioning of the EBA will be adapted and its role enhanced.

Common Resolution Rules

Agreement has yet to be reached on the establishment of a common resolution authority and fund (**Single Resolution Mechanism** or **SRM**) to deal efficiently with cross-border bank resolution and avoid taxpayers' money going into rescuing banks in the Eurozone area. The German Finance Minister recently indicated that, in order to establish a Single Resolution Authority with a suitably solid legal underpinning, changes to the Lisbon Treaty will be required. This, in turn, will mean referenda in certain EU member states and could not be expected to be achieved for some years. However, in the interim, an approach based on a resolution mechanism drawing on a network of national resolution authorities is likely to be the way forward. The European Commission is expected to publish a proposal on the SRM later in the summer.

Meanwhile, EU Ministers expect to reach agreement on common rules for bank recovery and resolution, applying to both Eurozone and non-Eurozone banks later this summer. The draft Recovery and Resolution Directive (**RRD**), applying to banks and investment firms, seeks to:

- prevent crises from emerging in the first place (for instance by ensuring that all banks have recovery and resolution plans in place);
- address them early on in the process if they do (for instance, establishing the power to appoint a special manager at a bank for a limited period to deal with any problems); and
- ensure that national authorities in all Member States will have a common toolkit and roadmap to manage the failure of banks in an orderly fashion, with a "bail-in" mechanism to call on shareholders and creditors when attributing losses of failed banks.

For a copy of our previous note on the proposed RRD, please click here.

As part of the RRD work, the EBA released two consultations on 20 May 2013 concerning draft Regulatory Technical Standards (**RTS**) related to (i) the assessment process of recovery plans by competent supervisors, and (ii) the range of scenarios to be used in those plans. The consultations run until 20 August 2013 and can be accessed here and here.

The RTS on the assessment of recovery plans outlines the general criteria that national authorities should follow when reviewing individual and group recovery plans developed by financial institutions. Those criteria are based on three key features: completeness, quality and overall credibility. The main objective is to ensure a common approach across the EU regarding the assessment of recovery plans so as to facilitate joint assessments of group recovery plans by different supervisory authorities.

The RTS specifying the range of scenarios to be used in recovery plans addresses the range of scenarios to be designed by financial institutions when testing their recovery plans. Given that the design of the appropriate scenarios depends on the specific features of each institution (activity, size, interconnectedness, business and funding model, etc.), the RTS attribute to institutions the responsibility of selecting relevant scenarios and to national supervisors the task of assessing the adequacy of the chosen scenarios.

However, the RTS provide a number of relevant events which need to be considered by banks when designing the most appropriate scenarios. The RTS also require at least three scenarios to be used: one covering a system-wide event, one covering an idiosyncratic event and one covering a combination of both types of events.

Deposit Guarantee Fund

Imminent adoption of a single deposit guarantee scheme currently appears unlikely.

Other EU Banking Developments

Ring-fencing of Retail Banking Operations/Structural Banking Reform

In May 2013, the European Commission published a consultation paper on reforming the structure of the EU banking sector. For a copy of this consultation paper, please click here. The paper focusses on the structural separation recommendation of the Liikanen High-Level Expert Group and considers, in relation to "too-big-to-fail" banks:

- whether structural reform, at the EU level is needed, noting that various EU states are already in the process of adopting national legislation in this context;
- if EU-wide action is desirable, which banks should be subject to separation? A variety of different tests are proposed. It is likely that, whatever test is adopted, about 30 – 35 banks would be selected to fall within the ring-fencing requirements;
- the scope of activities to be separated; and
- the strength of separation (for example, accounting separation, functional separation involving legal, economic, governance and/or operational separation and lastly, ownership separation).

The consultation period ends on 3 July 2013.

EU Directive on Retail Bank Accounts

In May 2013, the European Commission published a proposal for a Directive on the transparency and comparability of payment account fees, payment account switching and access to a basic payment account. For a copy of this proposal, please click here.

The Commission proposal aims to tackle three areas:

- **Comparability of payment account fees:** by making it easier for consumers to compare the fees charged for payment accounts by banks and other payment service providers in the EU;
- **Payment account switching:** by establishing a procedure to facilitate payment account switching to another bank or payment service provider; and
- **Access to payment accounts:** by allowing EU consumers who wish to open a payment account, without being residents of the country where the payment service provider is located, to do so. Basic bank accounts for the financially excluded are also contemplated so that Member States must ensure that at least one payment service provider offers a payment account with basic features in their territory. The public must be informed about the availability of these payment accounts. Basic bank accounts will allow withdrawals, bank transfers (and receipts) and a debit card. Overdrafts or credit facilities will not be permitted on basic accounts.

Mortgage Lending

On 3 May 2013, the European Council published a provisionally agreed text of the proposal for a Directive on credit agreements relating to residential property (the **MCD**). To view a copy, please click here. The text has been provisionally agreed with the European Parliament which is expected to vote on the proposal in June 2013.

The MCD sets out principles for marketing and advertising, obligations for pre-contractual information, requirements for information concerning credit intermediaries and the borrowing rate and anti-typing provisions. The text establishes regulatory and supervisory principles with regard to credit intermediaries, as well as provisions relating to the regulation and supervision of non-credit institutions (effectively, non-bank mortgage lenders).

Equity release and certain other products are outside the scope of the MCD. Agreements relating to residential property which is rented out are subject to optional opt-out by Member States if an appropriate national framework is in place.

Consultation on Draft Technical Standards on Securitisation Retention Rules

This consultation paper, published by the EBA on 22 May 2013, specifies (i) draft RTS to specify the securitisation retention rules and related requirements, and (ii) draft Implementing Technical Standards (**ITS**) to clarify the measures to be taken in the case of non-compliance with such obligations.

The RTS and ITS are published under Articles 393 to 399 of the proposed new Capital Requirements Regulation, part of the CRD IV package. These provisions will replace Article 122a of the current Capital Requirements Directive, containing the so called 5% "skin in the game" requirement applicable to credit institutions. Thus, the RTS and ITS will, once effective, replace the existing CEBS/EBA guidance under Article 122a. It is expected that the RTS and ITS will also apply to alternative investment funds and insurance companies.

The consultation runs until 22 August 2013 and EBA is requested to submit the draft RTS and ITS to the European Commission by 1 January 2014.

To view a copy of this consultation paper, please click here.

Consultation Papers on Passport Notifications

Two consultations relating to passport notification have been launched by EBA. The consultations specify the information which a credit institution must provide to the competent authority of its home Member State in order to notify the establishment of a branch or the provision of cross border services (without a branch) within the territory of another Member State. Information on changes to the branch notification, including termination of a branch operation, are also specified under the draft RTS

The consultations will run until 21 August 2013, and can be accessed by clicking here and here. They cover:

- draft ITS on Passport Notifications, specifying the standard forms, templates and procedures underlying the submission of passport notifications; and
- draft RTS on passport notifications, specifying the information to be notified to the competent authorities.

Regulation of Investment Firms

MIFID 2 and MIFIR

In April 2013, the European Council produced a note on the state of play of the proposed revised rules for markets in financial instruments, amending the Markets in Financial Instruments Directive (**MiFID**) and introducing a new Markets in Financial Instruments Regulation (**MiFIR**). To view a copy of this note, please click here.

The note recognised that, whilst significant progress has been made in agreeing the texts, with a compromise proposal having been tabled by the EU Presidencies, the key outstanding issue on which agreement is still to be reached is access to trading venues and central counterparties (**CCPs**) (MiFIR, Articles 28-30), with a divergence of opinion relating to whether the provisions will give rise to trading fragmentation and a loss of liquidity. Articles 28 and 29 of MiFIR require CCPs to accept transactions executed on different trading venues on a non-discriminatory basis (provided that those venues comply with the operational and technical requirements of the CCP) and for trading venues to provide access (including data feeds) on a transparent and non-discriminatory basis to CCPs that wish to clear transactions executed on the trading venue.

If the Committee of Permanent Representatives of the Council (**Coreper**) fails to agree the compromise proposal text and to resolve these concerns, the Presidency suggests that Coreper should note the divergence of views in its minutes and invite the EU Presidency to start negotiations with the EU Parliament on the basis of the Presidency compromise proposal, taking into account the need for further work to try to resolve outstanding issues.

Recovery and Resolution for non-banks

In May 2013, the European Commission published a roadmap covering the framework for crisis management and resolution for financial institutions other than banks. To view a copy of this roadmap, please click here. The roadmap considers the application of legislative measures relating to systemic financial institutions, primarily central counterparties, central securities depositories, insurance companies and hedge funds in order to ensure that non-bank financial institutions can be effectively resolved without causing systemic impact and without resorting to taxpayers to cover the cost of failure.

European Market Infrastructure Regulation

The European Market Infrastructure Regulation (**EMIR**) entered into force in August 2012 and sets out a range of new requirements affecting derivatives markets, including, amongst other things, certain mandatory clearing, reporting and risk-mitigation requirements as well as a new regulatory regime for CCPs.

However, EMIR was subject to transitional provisions as well as the adoption of technical standards in a number of areas. A large set of technical standards proposed by the European Securities and Markets Authority (**ESMA**) in September 2012 were endorsed by the European Commission in December 2012 (with the exception of one technical standard addressing colleges for central counterparties) and are available here. The implementing technical standards were published in the Official Journal in December 2012. The regulatory technical standards were subject to a right of scrutiny of the European Parliament and Council and were published in the Official Journal in February 2013, entering into force on 15 March 2013.

Certain other technical standards- including in relation to: (i) the scope of the mandatory clearing obligation, (ii) margin and capital requirements in respect of non-cleared OTC derivatives and (iii) contracts that are considered to have a direct, substantial and foreseeable effect in the EU or cases where it is necessary or appropriate to prevent the evasion of any provision of EMIR- are yet to be developed.

Alternative Investment Funds

On 22 July 2013, the Alternative Investment Fund Managers Directive (**AIFMD**) will come into force and significantly alter the legal foundation on which alternative investment funds (**AIFs**) are managed and marketed within Europe. Although the AIFMD's implementation is staged, it will affect most alternative investment fund managers from this date to some extent. Subject to transitional arrangements:

- Alternative investment fund managers (**AIFMs**) with their registered office in the European Economic Area (**EEA**) will become subject to the full requirements of the AIFMD and will therefore be required to obtain authorisation from their home Member State in order to manage AIFs.
- AIFMs based outside of the EEA will still be subject to certain "minimum conditions" set out in the AIFMD to the extent that they market AIFs under management to EEA investors. Until July 2015, such marketing will also need to be conducted in accordance with each relevant Member State's national private placement regimes, to the extent that such regimes are still available in that relevant Member State. Post-July 2015, non-EEA AIFMs are likely to be permitted to apply for authorisation in their Member State of reference, which will allow such AIFMs to market AIFs under management in reliance on a marketing passport without reference to the requirements of national private placement regimes. Alternatively non-EEA AIFMs that do not wish to obtain authorisation can continue to rely on national private placement regimes (where available) until 2018 – when it is expected that all private placement regimes will be removed.
- The "minimum conditions" for marketing in accordance with national private placement regimes includes compliance with some of the AIFMD's requirements (including, for example, those relating to investor disclosure and regulatory filings) and the establishment of appropriate cooperation agreements between the appropriate third country regulator and the EEA state.

On 30 May 2013, ESMA announced that it had approved co-operation arrangements between EEA regulators and 34 non-EEA supervisory authorities. Click here to view the press release. Although ESMA negotiated these arrangements centrally, they are bilateral agreements that must be signed by individual EEA supervisory authorities and their non-EEA counterparts. ESMA is continuing to negotiate co-operation agreements with further third countries in light of the 22 July 2013 deadline.

Given the proximity of the implementation date, a host of documentation has been published over the course of the last few months by European and UK bodies, which seeks to facilitate the implementation of AIFMD into national law. An overview of these is provided below.

Key European documentation

- On 22 March 2013, the text of the European Commission's Level 2 Regulation supplementing the AIFMD with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision was published in the Official Journal of the European Union. This regulation will have direct effect in member states from 22 July 2013 and adds a significant amount of detail to the high level principles established in the AIFMD. To view a copy of the Level 2 Regulation, click here.

- On 4 April 2013, ESMA published its Final Report and draft RTS on types of alternative investment fund managers (**AIFMs**) under the AIFMD. The draft RTS distinguish AIFMs managing AIFs of the open-ended type and AIFMs managing AIFs of the closed-ended type, in order to apply the rules on liquidity management, the valuation procedures and the transitional provisions of the AIFMD.

- The European Commission published a series of questions and answers concerning the AIFMD in March and April 2013. To view these, please click here.

- On 15 May 2013, the European Commission published Implementing Regulations which (i) establish a procedure for determining the Member State of reference of a non-EU AIFM, and (ii) establish the procedure for 'small' AIFMs which choose to opt in to the AIFMD's full authorisation requirements. To view copies of these implementing regulations, click here and here.

- On 24 May 2013, ESMA published its final 'Guidelines on key concepts of the AIFMD'. The guidelines are intended to help clarify which entities fall within the scope of the AIFMD. For a copy of the Guidelines, click here.

On 24 May 2013, ESMA published a consultation paper on guidelines for the reporting requirements under Articles 3 (reporting obligations for funds exempted from the AIFMD as de minimis) and 24 of the AIFMD (AIFM reporting obligations to competent authorities). For a copy of the consultation paper, click here.

Key UK documentation

- In January 2013, HM Treasury published a draft for consultation of the Alternative Investment Fund Managers Regulation 2013. This regulation will implement the AIFMD into UK law. Following consultation, HM Treasury published a revised version of the regulation on 13 May 2013. To view a copy of the latest version of the UK regulation, and HM Treasury's response to further consultation, please click here and here.

- On 19 March 2013, the FSA published Part 2 of its Consultation Paper on the Implementation of the AIFMD. This paper contained a draft FSA Handbook text, including a new section to Chapter 8 '*Financial promotion and related activities*' of PERG. This chapter provides guidance on, inter alia, the definition of marketing, how draft communications fit within the meaning of marketing, the territorial scope of the UK regulation's marketing restrictions and the meaning of passive marketing. To view a copy of this paper, click here. It is likely that the Financial Conduct Authority (**FCA**) (as the FSA's successor for the relevant purposes from 1 April 2013) will publish a revised draft Handbook text in due course as a result of HM Treasury's amendments to the Alternative Investment Fund Managers Regulation 2013. The FCA is expected to publish a third Consultation Paper on the implementation of AIFMD shortly.

- In May 2013, HM Treasury published a Question & Answer paper which responds to many of the queries raised during the January 2013 consultation process referred to above. This confirms *inter alia* that both UK-based and non-UK based AIFMs may be entitled to benefit from a one-year transitional period in order to comply with the AIFMD's requirements. To view a copy of this paper, please click here.

Market Abuse and Insider Dealing

Trialogue discussions between the European Council, Parliament and the Commission have been on-going in relation to the Directive relating to the proposed Regulation on insider dealing and market manipulation (**MAR**) and the proposed Directive on criminal sanctions for insider dealing and market manipulation (**MAD 2**). The European Parliament currently expects to consider the proposals in July 2013.

Shadow Banking

The Financial Stability Board (FSB) closed its consultations on Shadow Banking in January 2013, indicating that it will finalise its policy recommendations in this area in September 2013. We anticipate that the European Commission will publish next step legislative proposals, if any, after that date.

Benchmark Regulation

Benchmark setting and submission became regulated activities in the United Kingdom on 1 April 2013 and benchmark manipulation is now a specified criminal offence under English law. Revisions to the European market abuse rules will also specify benchmark manipulation as a criminal offence. Separately, a number of international initiatives in relation to benchmark setting and regulation are under way.

ESMA and EBA Joint Consultation on Principles for Benchmark Setting Processes in the EU

In January 2013, EBA and ESMA launched a consultation on the introduction of Principles for Benchmark Setting Processes in the EU, developing a set of Principles to address the activities of reference-rate and other benchmark providers, administrators, publishers and market participants who submit data.

The Principles are designed as a first step towards a potential formal regulatory and supervisory framework for benchmarks to be developed in the EU and also take into account other international efforts in this field.

The proposed Principles include a general framework for benchmark settings (calculation methodology, governance, supervision, transparency of the methodology, contingency plans, etc.). They also provide guidance to firms involved in benchmark data submission and to benchmark administrators, calculation agents, publishers and users.

To view a copy of the consultation paper, click here.

International Organization of Securities Commissions (IOSCO) Principles for Financial Benchmarks

In April 2013, IOSCO published its second consultation report on Principles for Financial Benchmarks. By setting out clear standards for benchmark administrators and other relevant bodies on benchmark quality, methodology, governance, and accountability mechanisms, the Principles are intended to strengthen the reliability and integrity of benchmarks used in financial markets. This goes beyond work on interest rate benchmarks, to include other forms of references rates, indices and prices.

The consultation period closed on 16 May 2013, although a copy of the consultation paper can be accessed by clicking here.

The FCA's work on reforming LIBOR has helped inform the development of this set of Principles. Areas covered by the Principles include roles and responsibilities of benchmark administrators (and where applicable, third parties and contributors to benchmarks); managing conflicts of interest; developing a control framework; benchmark design and inputs; benchmark methodology and periodic review; transition; complaints procedures; audit requirements and record keeping; and co-operation with relevant regulatory authorities.

Securities

Prospectus Directive

In April 2013, a final version of the Commission Delegated Regulation amending Regulation (EC) No 809/2004 as regards the disclosure requirements for convertible and exchangeable debt securities was published. For a copy of the Delegated Regulation, click here.

The Delegated Regulation seeks to clarify the disclosure regime applicable to convertible or exchangeable debt securities and which of the current requirements are applicable to the underlying shares. The Delegated Regulation has not yet entered into force and is subject to the right of the Parliament and Council to express objections.

Separately, ESMA is consulting on Draft RTS on specific situations that will require the publication of a supplement to a prospectus. To view the consultation, click here. Responses to the consultation should be submitted online by 28 June 2013.

Financial Transaction Tax

Some progress has been made on the controversial Financial Transaction Tax (**FTT**), with the European Commission seeking to adopt legislation introducing a FTT on the basis of '*enhanced cooperation*'. The use of the enhanced cooperation procedure requires the consent of the European Council and requires the participation of only nine EU member states. Any legislation adopted on this basis will bind only those member states which adopt it rather than all 27 EU member states.

The European Council authorised the use of the enhanced cooperation procedure to introduce a FTT in January 2013 and the European Commission adopted a proposal for a Directive introducing a FTT into the following EU member states: Germany, France, Spain, Italy, Belgium, Austria, Estonia, Slovenia, Slovakia, Portugal and Greece in February 2013. To view a copy of this proposal, please click here.

Subsequently, the UK issued a legal challenge to the European Council's decision to approve use of the enhanced cooperation procedure. The UK's objections relate to the extra-territorial effect of the proposed Directive.

The proposed Directive currently envisages that each Participating Member State will adopt and publish, by 30 September 2013 (at the latest), the laws, regulations and administrative provisions necessary to implement the FTT. These provisions are expected to apply from 1 January 2014, although a transitional period will apply in order to allow market operators some time to adjust to the new rules.

The proposed FTT will apply to most secondary market transactions and will not be limited to trade in organised markets (such as regulated markets, multilateral trading facilities or systematic internalisers); it is also expected to cover over-the-counter trading.

The rate of taxation will be fixed by each Participating Member State as a percentage of the taxable amount and shall, in any event, not be lower than (i) 0.1% in respect of financial transactions other than those related to derivatives contracts, and (ii) 0.01% in respect of financial transactions related to derivatives contracts.

The proposed FTT is expected to be applied on the basis of a so-called '*residence*' principle and therefore apply to those financial institutions which:

- have been authorised by a Participating Member State to enter into the relevant financial transaction;
- have their registered seat within a Participating Member State;
- have their permanent address or usual residence in a Participating Member State; or
- have a branch in a Participating Member State (in relation to transactions carried out by that branch).

The Directive is founded upon the general rule that FTT will not be payable where there is no link between the economic substance of the transaction and the territory of any Participating Member State.

Nevertheless, in order to prevent tax avoidance, the draft Directive currently envisages that FTT may have extra-territorial effect as a result of the following:

- The reference to a financial institution 'authorised' by a Participating Member State (for residency purposes) will extend to financial institutions which are entitled to operate as financial institutions in a Participating Member State as a result of passporting rights.
- The 'residence' principle is expected to be supplemented by elements of the so called 'issuance' principle. Thus, for transactions in certain financial instruments (for example, transferable securities, money market instruments and some derivatives contracts if traded on an organised platform), the parties involved will be considered as resident in a Participating Member State if the financial instrument was issued from that Participating Member State.
- Where one of the parties to a financial transaction is established in a Participating Member State, a financial institution counterparty that is not so established will nevertheless be deemed to be established in that Participating Member State.

The FTT proposals have been extremely controversial and, if enacted, are likely to be adopted in a different form from that outlined above. Currently, it appears that 1 January 2014 is an ambitious and unlikely date for implementation, and recent press reports suggest that European officials are considering reducing the level of the proposed tax considerably.

Money Laundering

In February 2013, the European Commission introduced the following new proposals:

A directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (the **Fourth Money Laundering Directive**, or **4MLD**). A copy of this proposed directive can be viewed by clicking here; and

- A regulation on information accompanying transfers of funds to secure "due traceability" of these transfers. To view a copy of this proposal, please click here.

In particular, 4MLD includes:

- a mechanism for identification of beneficial owners. Companies will be required to maintain records as to the identity of those who stand behind the company in reality;
- new rules on customer due diligence in order to ensure a better knowledge of customers and a better understanding of the nature of their business and to clarify that simplified procedures should not be perceived as full exemptions from customer due diligence;
- expanded provisions dealing with politically exposed persons;
- coverage of the gambling sector (not just 'casinos', as at present);
- an explicit reference to tax crimes within the serious crimes which can be considered as predicate offences to money laundering; and
- a requirement that traders in high value goods dealing with cash payments of €7,500 or more fall within the scope of the directive, a reduction from the current €15,000 threshold.

Credit Ratings Agencies

On 31 May 2013, Regulation (EU) No 462/2013 (the **Amendment Regulation**[1]) that further amends Regulation (EC) No 1060/2009 on credit rating agencies was published in the Official Journal. This was accompanied by a short Directive (the **Amendment Directive**[2]) amending Directive 2003/41/EC on institutions for occupational retirement provision, Directive 2009/65/EC on undertakings for collective investment in transferable securities and the Alternative Investment Fund Managers Directive 2011/61/EU in respect of over-reliance on credit ratings.

1 Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:146:0001:0033:EN:PDF.

2 Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:145:0001:0003:EN:PDF.

The Amendment Regulation and Amendment Directive aim to address regulatory concerns related to the credit rating market, including over-reliance by investors and financial services firms on the risk assessments of investments provided by credit rating agencies, conflicts of interests that may affect these risk assessments and significant barriers to market entry by new credit rating agencies. However, the Amendment Regulation imposes new obligations not only on credit rating agencies but also on issuers, originators and sponsors in connection with structured finance instruments.

In particular, the following changes affect, or may affect, issuers, originators and sponsors of structured finance instruments which are established in the European Economic Area:

- an obligation on the issuer, the sponsor and the originator to publish extensive information on structured finance instruments;
- a requirement for two independent credit ratings of structured finance instruments by two credit rating agencies;
- a requirement to consider the appointment of a smaller credit rating agency when using at least two credit rating agencies; and
- mandatory rotation of credit rating agencies in relation to the rating of re-securitisations with underlying assets from the same originator.

Most of these requirements apply from the 20th day from the publication of the Amendment Regulation in the Official Journal, i.e. from 20 June 2013. However, the precise disclosure requirements on issuers, sponsors and originators are yet to be specified in technical standards and become applicable only at a later date. Further, ESMA has yet to publish certain information that will assist with evaluating the possibility of appointing smaller credit rating agencies.

Retail Structured Products

On 18 April 2013, IOSCO published a Consultation Report on the Regulation of Retail Structured Products. For a copy of the consultation report, which is open for comment until 13 June, click here. The Report sets out a proposed regulatory toolkit that IOSCO members could consider using in their regulation of retail structured products. These are not mandatory and the paper has been prepared on the basis that individual IOSCO members are best placed to determine the appropriate regulatory response within their own jurisdictions, based on the characteristics of their own markets and regulatory frameworks.

UK Regulatory Reform

New UK Regulatory Structure

The UK's Financial Services Authority ceased operating on 1 April 2013, and was replaced by the new, twin peaks regulators, the FCA and the Prudential Regulation Authority (**PRA**). For a copy of our note explaining the new regime and highlighting key changes, click here.

Consumer Credit Regulation

The UK Government has announced that consumer credit regulation in the UK will cease to fall under the auspices of the Office of Fair Trading. Instead, the FCA will become the new regulator from 1 April 2014, with an interim regime running until 1 April 2016. For a copy of the FSA's consultation paper relating to the FCA's proposed new role, click here. The consultation period ended on 1 May 2013.

New Authorisation Regime for Newly Established Banks

The PRA is introducing a new, simplified authorisation regime for newly incorporated banks. The new authorisation process for applicants applying to be a bank or building society is separated into distinct stages to provide a structured approach:

- pre-application;
- assessment; and
- for some applicants, mobilisation.

The new mobilisation stage is primarily designed for new start-up banks to aid the operational elements of becoming a fully functioning bank, such as seeking additional capital or implementing full IT infrastructure.

If the decision is taken at the pre-application stage that mobilisation is appropriate for the applicant bank, the PRA will grant authorisation but with a restriction that limits what the new bank can do. This enables it to demonstrate to investors, prospective personnel and third party service providers that it has received authorisation (albeit with restriction) from the PRA and to prepare for becoming a fully functioning bank. At the end of the mobilisation stage, the PRA will assess whether the bank meets relevant requirements and, if the PRA and FCA are satisfied that it does, the PRA will lift the restriction and the bank will be able to conduct in full all activities for which it applied.