CLIFFORD CHANCE

Debevoise & Plimpton

PASLA 2018

Legal, Tax and Regulatory

Moderators:
Paul Landless – Clifford Chance
Gregory J. Lyons – Debevoise & Plimpton

Panelists:
Jenny Cosco – Goldman Sachs
Glenn Horner – State Street
Gary Plummer – J.P. Morgan
Rebecca Terner Lentchner – BNY Mellon

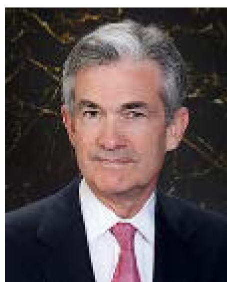
GLOBAL LEGAL AND REGULATORY ISSUES

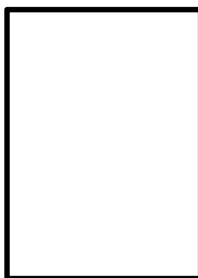
- U.S. Political Climate
- Status of U.S. and Global Regulations
  - Standardized Approach for Credit Risk
  - Internal Ratings Based Approaches for Credit Risk
  - Operational Risk
  - Capital Floor
  - Credit Valuation Adjustment
  - Leverage Ratio
- Appendix

PERSONNEL IS POLICY

Federal Reserve Leadership

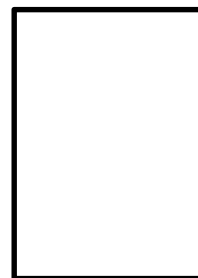
Federal Reserve Board – Presidential Appointments


Chair Powell

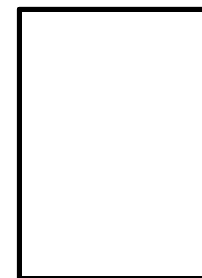

Vice Chairman
(*Open*)

Marvin Goodfriend
(*Nominated 11/29/17*)

Vice Chairman of Supervision Randal Quarles


Governor*
(*Open*)

Governor Brainard
Term Expires: January 31, 2026
(Sole survivor)


Governor*
(*Open*)

Other Notable Positions:

General Counsel Mark Van Der Weide

Deputy Director in the Division of Supervision and Regulation Timothy P. Clark
(*retiring*)

"**Personnel is policy. And changing the personnel will change the policy, will change the interpretation. And we think that is very important**" – Gary Cohn, Director of the National Economic Council (April 20, 2017)

*One member of the Board must have primary experience working in or supervising community banks. 12 U.S.C. § 241.

PERSONNEL IS POLICY

FDIC, OCC and CFPB Leadership

Federal Deposit Insurance Corporation

Chair Gruenberg

(term expires 11/15/2017)

Vice Chairman Hoenig

Chair
Jelena McWilliams

(*nominated 11/30/2017*)

Office of the Comptroller of the Currency

Joseph Otting

(*Confirmed 11/16/17*)

- FDIC change needed for interagency action
- OCC issues first new activity list since 2011 on Oct. 13, 2017
- Cordray steps down November 30, 2017, Mick Mulvaney as interim Director
  - CFPB a “sick, sad joke”*

Consumer Financial Protection Board

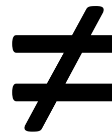
(*Interim Director*)

**The Atlantic*, “The Dismal Future of Trump’s Least Favorite Agency” (Nov. 17, 2017)

PERSONNEL IS POLICY

Top of House vs. Local/Examiner Dichotomy

Senior Regulator Mindset Changes



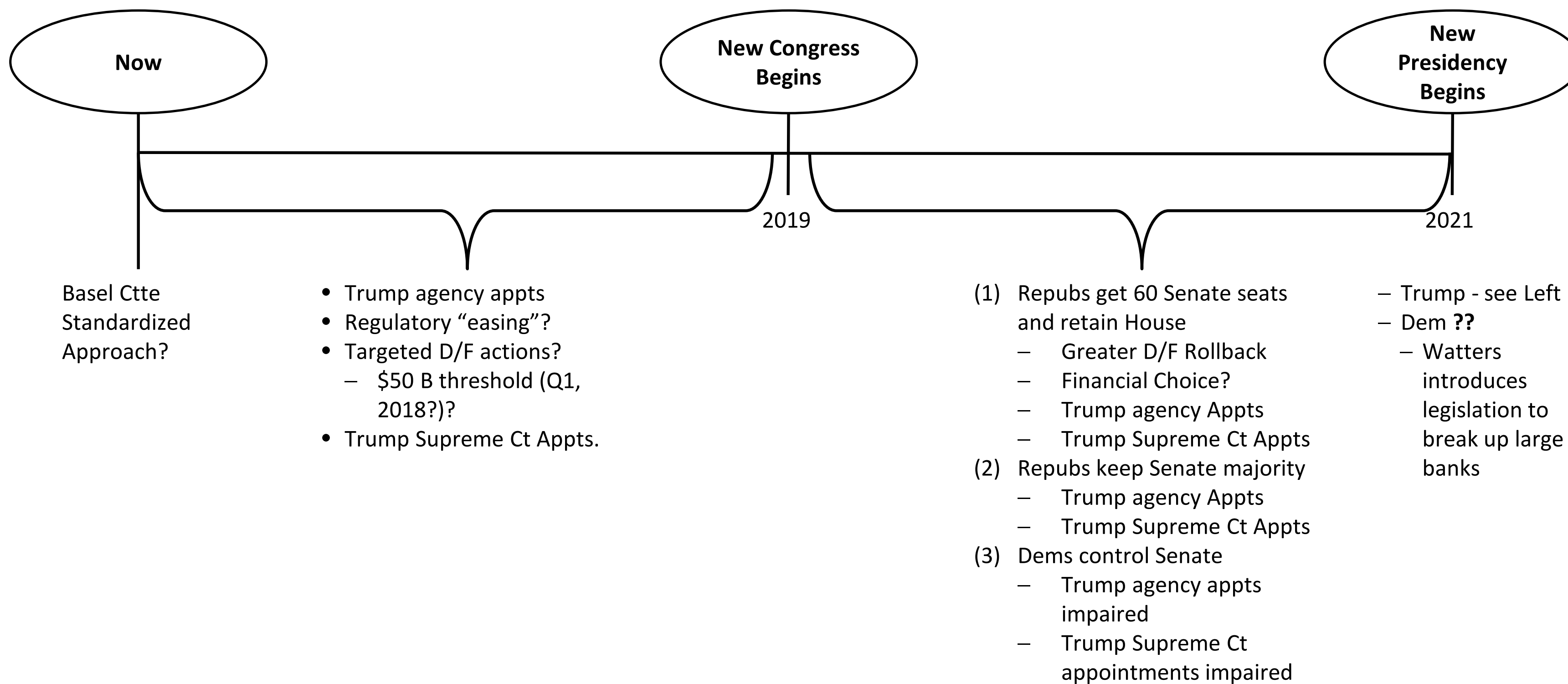
Local / Examiner Mindset Changes

- Clients continue to see difficulties "on the ground."
- Removal of rules may not be enough.
- Hope: Quarles: "I have come into this position thinking that…changing the tenor of supervision will be the biggest part of what it is that I do." *
- But GAO: FRB not guarding against regulatory capture.
- States (esp. DFS) also ↑ scrutiny (and enforcement).
- State AG: "redouble efforts" to protect citizens.**

*Source: Am. Banker, *Quarles says Fed taking taking "fresh look" at regulation, fintech. (Nov. 7, 2017)*
**Am. Banker, *Mulvaney unfit to lead CFPB: Schneiderman, 16 state AGs* (Dec. 12, 2017)

PERSONNEL IS POLICY

Key Dates for People/ Policy/ Law



Status of US and Global Regulations

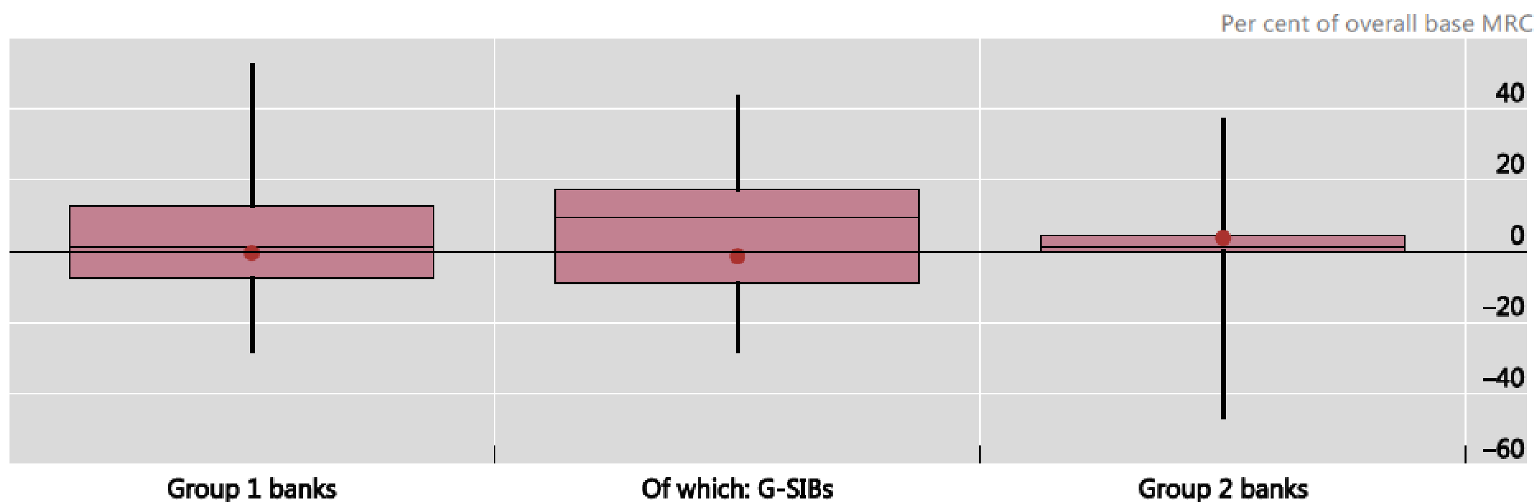
BACKGROUND

Overview of 2017 Revisions

- **Basel III**. Basel III is a set of internationally agreed measures developed by the Basel Committee on Banking Supervision in response to the financial crisis of 2007-2009.
  - The initial set of Basel III revisions focused on the numerator of the capital ratio.
  - This most recent set of reforms focuses on the denominator: risk-weighted assets.
- **Motivation**. The 2017 Reforms address key weaknesses the Basel Committee identified in the Basel II framework during the financial crisis.
  - A number of studies found wide variation in RWAs across banks that could not be explained solely by differences in banks' portfolios. This undermined comparability and confidence in capital ratios.
  - The Basel Committee noted that banks had strong incentive to minimize risk weights when using internal models approaches to calculate capital requirements.
- **Political Considerations**. Negotiating the 2017 Reforms was a difficult and painstaking process, due in part to differing implementation of Basel II/III in member jurisdictions and in part due to political pressures.
  - U.S. regulators pushed hard for many of these reforms. (echoing the original Basel I negotiation process).
  - Some European jurisdictions, for example, significantly resisted parts of the revisions (as we will discuss).

BACKGROUND

Results of QIS; Overall Impact



- **Small Average Impact**. The average total change in Tier 1 minimum required capital (MRC) at the target levels was -0.5% for Group 1 banks, -1.4% for G-SIBs and +3.8% for Group 2 banks.
- **Significant Dispersion**. Despite the small average impacts, the changes varied widely across banks, with the largest variation occurring among the very largest banks.

Standardized Approach to Credit Risk

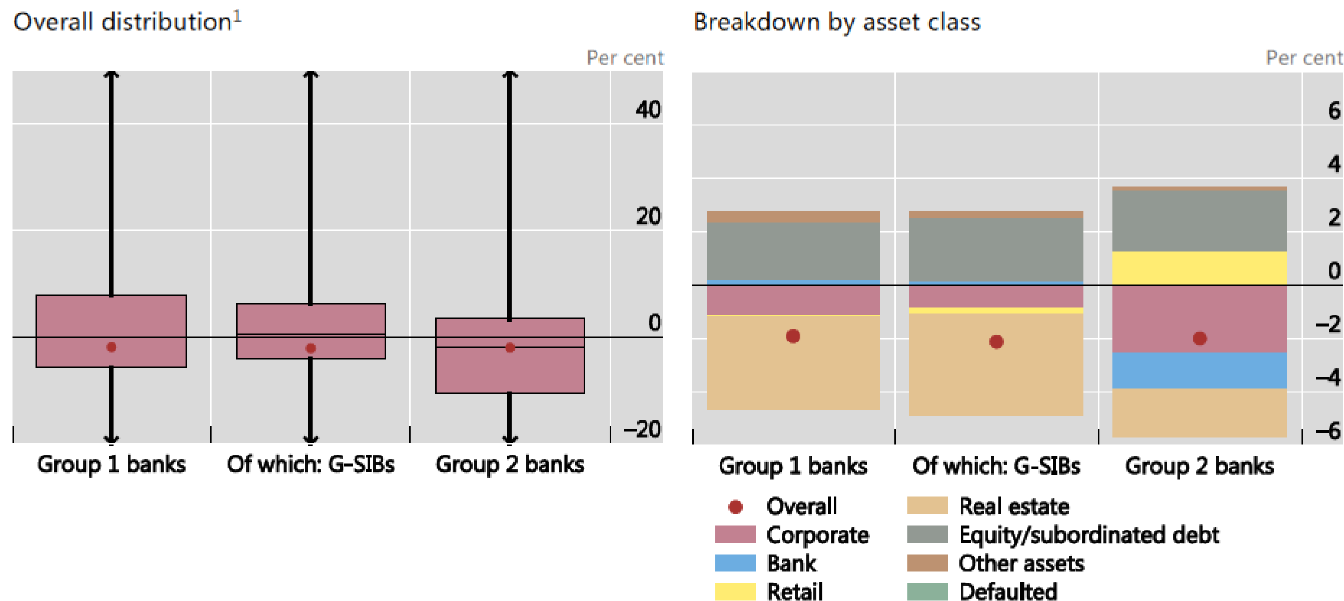
STANDARDIZED APPROACH FOR CREDIT RISK

Key Thematic Changes

- **Increased Risk Sensitivity**.
  - The original Basel II/III reforms were perceived as overly simplistic and insufficiently risk sensitive.
  - The 2017 Reforms introduce more detailed, granular risk weights for many exposure classes.
- **Reduced Reliance on External Credit Ratings**.
  - Over-reliance on external ratings was perceived to be a major cause of the financial crisis.
  - Certain jurisdictions (e.g. the United States) also faced difficulties in implementing capital requirements based on external ratings.
  - The 2017 Reforms require banks to conduct sufficient diligence when using external ratings.
  - The 2017 Reforms also introduce approaches for jurisdictions that cannot or do not wish to rely on external ratings.

STANDARDIZED APPROACH FOR CREDIT RISK

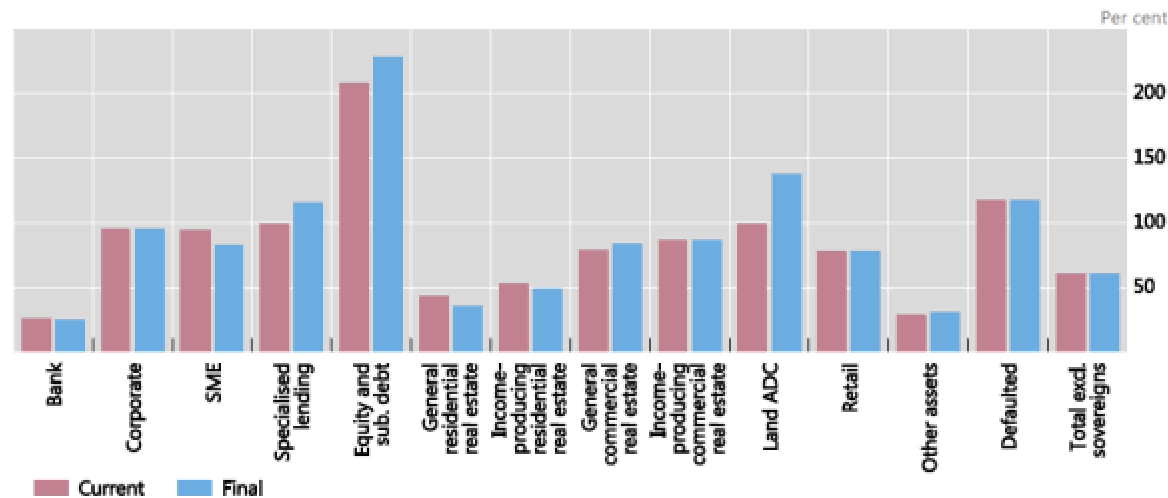
Results of QIS; Overall Impact



- **Overall Impact**. The average change in MRC for Group 1 banks was -1.9% and for Group 2 banks was -2.0%, with large dispersion across banks.
- **Main Contributors**. The main contributors to overall change are the decrease in MRC for real estate exposures (-3.5%) and an increase in MRC for equity and subordinated debt exposures (2.2%).

STANDARDIZED APPROACH FOR CREDIT RISK

Results of QIS; Risk Weights by Asset Class



- **Most Asset Classes Flat**. The risk weights for most asset classes were flat.
- **Effect of Sub-Classes**. The introduction of new sub-asset classes (e.g. specialized lending and land ADC) tended to decrease the risk weights in the original asset classes (corporate and general residential real estate).

STANDARDIZED APPROACH FOR CREDIT RISK

Hot Topic: Corporate and Bank Exposures

External Credit Ratings.

- Basel II relied heavily on external credit ratings to assign risk weights.
  - This presents difficulties for jurisdictions that do not permit reference to external credit ratings (e.g. Section 939A of the Dodd-Frank Act in the U.S.).
- In the U.S., all general corporate exposures are risk weighted at 100%.
- The 2017 Reforms include a "secondary" methodology for jurisdictions that do not permit reference to external credit ratings.

Exposures to Securities Firms

- Under the Basel II/III frameworks, exposures to brokers and other securities firms could be risk weighted like banks.
- In the U.S., securities firms are risk weighted like general corporates.

STANDARDIZED APPROACH FOR CREDIT RISK

Hot Topic: Credit Risk Mitigation for Securities Financing Transaction

Revised Collateral Haircut Approach.

- The current collateral haircut approach for securities financing transactions has a number of shortcomings. Most notably:
  - It does not permit recognition of correlation between long and short positions; and
  - It does not provide any benefit for portfolio diversification.
- The 2017 Reforms revised the potential future exposure component as follows:

$$PFE = 0.4 \cdot Net\ exposure + 0.6 \cdot \frac{Gross\ exposure}{\sqrt{N}}$$

Where:

$$Net\ exposure = \left|\sum_i E_i H_i\right|$$

$$Gross\ exposure = \sum_i E_i \left|H_i\right|$$

E_i = the net current value of each security issuance under the netting set.

H_i = the haircut for the exposure (negative for securities borrowed or reversed in).

N = the number of security issues contained in the netting set (excluding issuances where the value of E_i. is less than 1/10 the value of the largest exposure in the netting set).

Internal Ratings Based Approaches for Credit Risk

CORPORATE AND BANK EXPOSURES

Availability of the A-IRB

Changes

- The Basel Committee concluded that banks, other financial institutions and large corporates are considered to be low-default exposure that make reliable parameter estimation difficult.
- Therefore, the Basel Committee reasoned, it was unlikely that banks' internal estimates of potential defaults or losses from such exposures would be any more reliable than estimates based on market data.
- The 2017 Reforms no longer permit usage of the A-IRB for exposures to:
  - General corporates belonging to a group with total consolidated annual revenues greater than €500 million; and
  - Banks, securities firms and other financial institutions.

Observations

- Higher capital charges across the board for this exposure class for most banks.
- The impact on the U.S. is unclear, given that the U.S. implementation of Basel II/III does not permit F-IRB.

CORPORATE AND BANK EXPOSURES

Generally Applicable Changes

Changes

- Introduction of a PD floor of 5 basis points.
- Application of a 1.25 multiplier to the asset correlation function for financials.
- Removal of the 1.06 scaling factor in consideration of the other changes made to the IRB framework and the introduction of the standardized capital floor.

Observations

- Most amounts under the Basel II/III reforms are denominated in Euros, while the asset correlation multiplier contemplates dollar amounts (likely because the 1.25 correlation multiplier appears to be based on the U.S. capital rules).
- Currently, the PD floor for most exposures is 3 basis points.

INTERNAL RATINGS BASED APPROACHES

Corporate and Bank Exposure: Changes to the F-IRB

Changes

- Lower the unsecured LGD for non-financial corporates to 40% (from 45%).
- Revised secured LGD framework (largely cosmetic changes from a "overcollateralization" concept to a "haircut" concept):
  - higher haircuts for non-financial collateral;
  - lower supervisory LGDs for eligible non-financial collateral;
  - removal of the concept of required minimum collateral; and
  - a gross up for exposures secured by non-financial collateral.
- CCFs aligned with the revised standardized approach.

Observations

- Notably, incorporation of the standardized approach CCFs means a 10% CCF for unconditionally cancelable commitments, which could significantly increase the capital charges for many types of facilities currently structured to have a 0% CCF.
- The impact on the U.S. is unclear, given that the U.S. implementation of Basel II/III does not permit F-IRB.

CORPORATE AND BANK EXPOSURES

Changes to the A-IRB

Changes

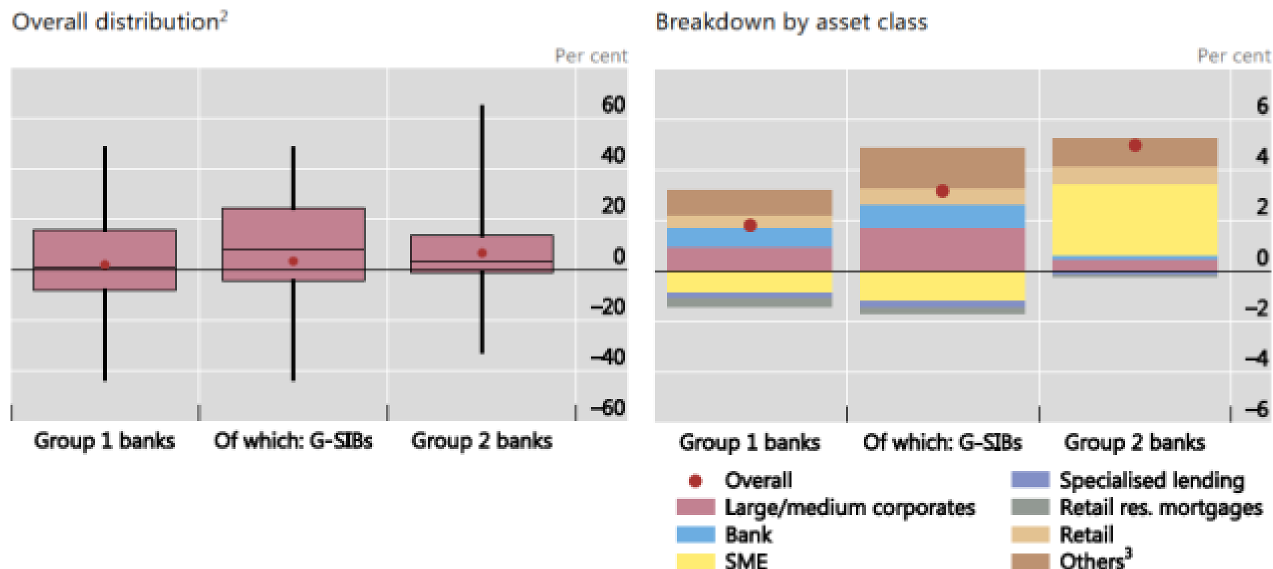
- Introduction of LGD floors as illustrated in the Appendix.
- Limits on the ability to estimate CCFs (limited to revolving commitments to extend credit, purchase assets or issue credit substitutes, provided the exposures are not subject to a 100% CCF under the F-IRB.
- Imposition of an EAD floor equal to the sum of the on-balance sheet amount and 50% of the off-balance sheet amount calculated using the applicable CCF under the standardized approach.
  - This does not apply to EADs for SFTs and OTC derivatives.

Observations

- Currently, the U.S. does not impose LGD or EAD floors for corporate and bank exposures.
- The secured LGD floors are lower than those proposed in the Basel Committee's 2015 consultation.

INDUSTRY IMPACT

Results of QIS; Overall Impact

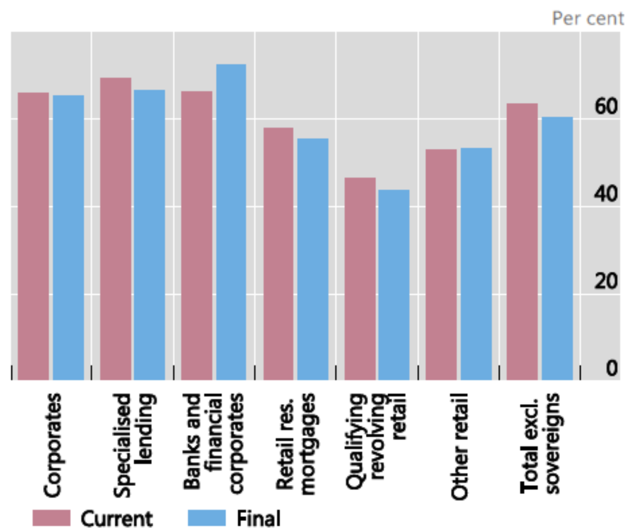


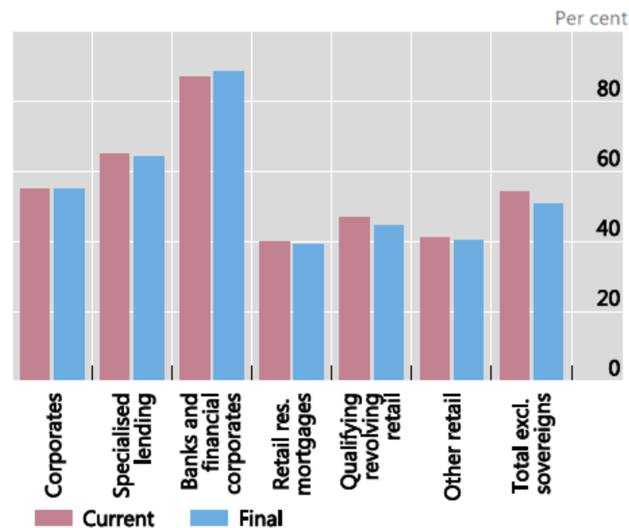
- **Overall Impact**. The average change in MRC for Group 1 banks was 2.0% (3.4% for G-SIBs) and for Group 2 banks was 6.7%, with large dispersion across banks.
- **Main Contributors**. For Group 1 banks, the corporate asset class contributed to 0.9% to the 1.8% overall increase in MRC, while exposures and banks and financial corporates contribute 0.7%.
  - Countervailing effects of removal of A-IRB and removal of the 1.06 multiplier.

INDUSTRY IMPACT

Results of QIS; Comparison with Standardized

Ratio of current and final IRB risk weights to final standardised approach — Graph 7





Note that the final standardised approach also assumes that only non-modelled approaches are used for counterparty credit risk.

Source: Basel Committee on Banking Supervision. See also Table B.7.

- **Generally Stable**. The gap between risk weights under the standardized and IRB approaches is generally stable. For sub-classes for which modeling is restricted, the ratios are closer to 100%.

Operational Risk

OPERATIONAL RISK FRAMEWORK

Rationale and Overview of Changes

Rationale for Revisions

- ORC requirements under the Basel II/III frameworks were insufficient to cover operational risk losses incurred (primarily) by banks that were under the AMA; and
- Internal models were inadequate to model operational losses due to the nature of the losses (covering events such as misconduct and inadequate systems and controls).
  - It is unclear whether the new standardized approach is sufficient to cover these losses or how certain components of the framework will be used (e.g. scenarios)
- The Basel Committee has eliminated the three existing standardized approaches and the advanced measurement approach for calculating operational risk capital requirements.

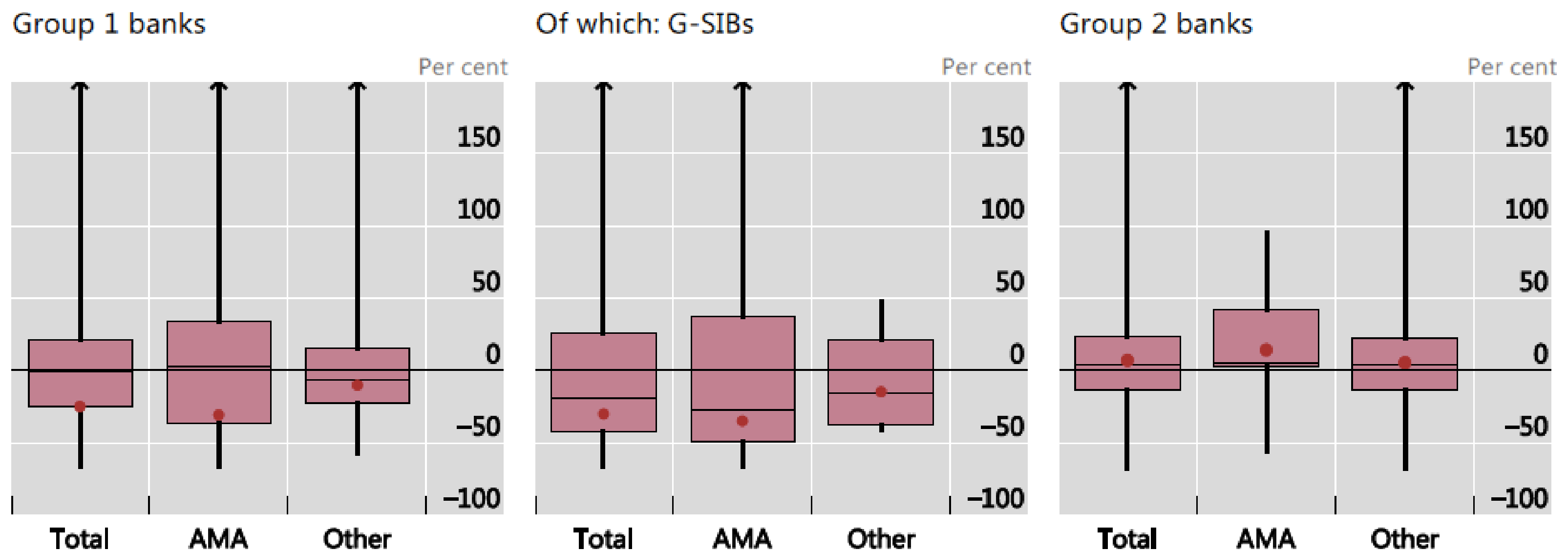
Basic Formula

$$ORC = BIC \bullet ILM$$

- the Business Indicator ("BI"), which replaces gross income as the primary indicator of operational risk exposure (sum of (1) interest, lease and dividend component, (2) services component and (3) financial component);
  - Operational risk losses are included in the services component and additive to BI. This addresses issues with the usage of gross income in the prior standardized approaches.
- the Business Indicator Component ("BIC"), which is the BI multiplied by one of three possible Basel-determined marginal coefficients; and
- the Internal Loss Multiplier ("ILM"), a scaling factor that incorporates a bank's operational loss history.

OPERATIONAL RISK FRAMEWORK

Results of QIS; Overall Impact



- **Significant Average Decreases**. QIS results show significant average decreases for the largest banks, but a large dispersion between banks.
- **Supervisor Add-Ons**. The QIS data does not reflect supervisory add-ons. The increases in MRC may be overstated and reductions may be understated.

Capital Floor

STANDARDIZED CAPITAL FLOOR

Mechanics of Floor

Floor is higher of:

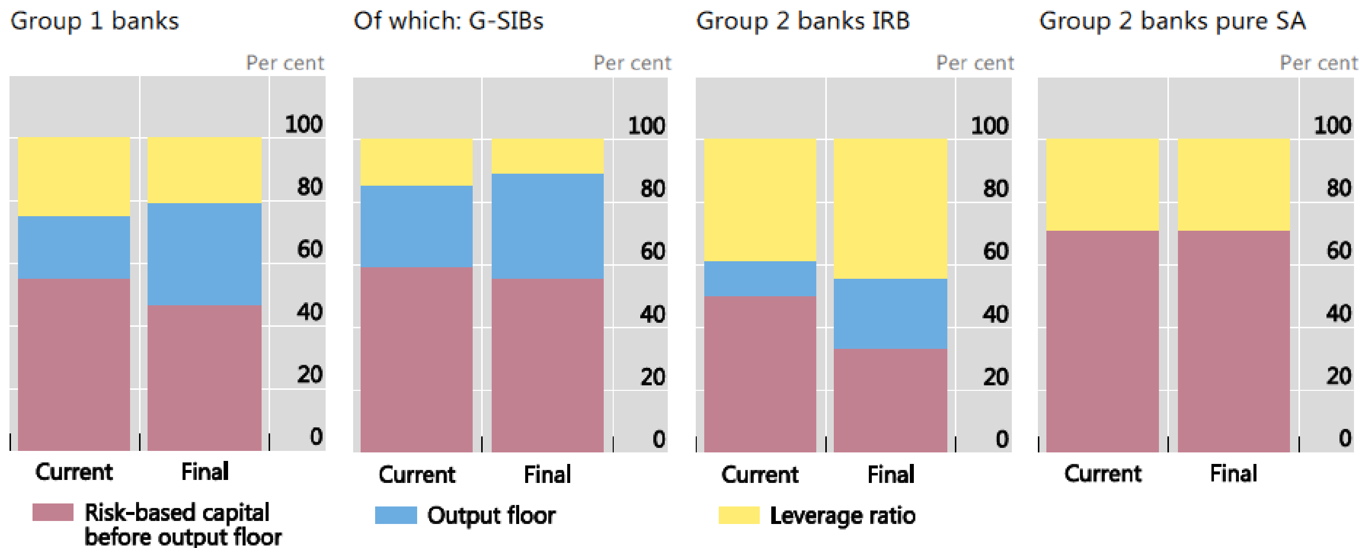
- Total RWAs calculated using the approaches for which the bank has supervisory approval (e.g. an IRB approach); and
- 72.5% of the total RWAs calculated using only the standardized approach.
- Implementation phased in beginning **2022** (ending **2027**).

Requirements for Calculation:

- Credit risk. Banks must use the revised standardized approach as set out in the 2017 Reforms.
- Counterparty credit risk. Must use SA-CCR for derivatives.
- Credit valuation adjustment risk. Banks must use the revised standardized approach for credit valuation adjustment ("CVA"), the Basic Approach, or 100% of a bank's counterparty credit risk capital requirement (depending on which approach the bank is eligible for and uses for CVA risk).
- Securitization framework. Banks should use the external ratings-based approach ("SEC-ERBA"), the standardized approach ("SEC-CA"), or a risk-weight of 1250%.
- Market risk. Banks should use the standardized approach for market risk. When determining the default risk charge component for securitizations held in the market book, banks must also use the SEC-ERBA, SEC-SA, or a risk-weight of 1250%.
- Operational risk. Banks must use the revised standardized approach as set out in the 2017 Reforms.

STANDARDIZED CAPITAL FLOOR

Results of QIS; Changing Binding Constraints



- **Changing Binding Constraints.**
  - Among the Group 1 banks, more banks will be constrained by the capital floor, and fewer will be constrained by the leverage ratio and RBC before application of the floor.
  - More group 2 banks (that use IRB) will be constrained by the capital floor / leverage ratio.

STANDARDIZED CAPITAL FLOOR

Implementation Challenges

Implementation in the U.S.

- The United States already has a capital floor in place in the form of the Section 171 of the Dodd-Frank Act (the Collins Amendment). Pursuant to the Collins Amendment, U.S. banks subject to the "advanced approaches" must calculate capital ratios under both the standardized approach and the advanced approaches and apply the more punitive of the two.
- Although the U.S. federal banking agencies have indicated that they are considering how to apply the 2017 Reforms in the United States and that any changes will go through the standard notice-and-comment rulemaking process, the U.S. standardized capital floor is mandated by statute, which will require Congressional action to modify. For these reasons, as well as structural differences between the U.S. standardized approach and the Basel III standardized approaches, it remains unclear how the output floor will be implemented in the United States, if at all.
- Currently, U.S. banks that use the U.S. standardized approach are not required to calculate a number of capital charges that form a part of the Basel III standardized approaches, e.g. capital charges CVA and operational risk.

Credit Valuation Adjustment (CVA)

CREDIT VALUATION ADJUSTMENT

Overview of Changes

Current CVA Framework

- The current CVA framework consists of the standardized approach for CVA and the internal models approach for CVA.
- The Basel Committee sought to revise the CVA framework in order to:
  - Capture a broader range of CVA risks and better recognize CVA hedges;
  - Align with accounting CVA standards and industry best practices; and
  - Align with the revised Basel market risk capital framework finalized in early 2016.

Changes

- Enhanced Risk Sensitivity. The 2017 Reforms enhance the risk sensitivity of the Basel II/III CVA framework by taking into account the exposure component of CVA risk along with its associated hedges.
- Eliminating IMA. The 2017 Reforms eliminate the internal model method, replacing it with a "basic approach for CVA" – a simpler standardized approach for CVA.
- Re-Calibration. Following revisions to the Basel Committee's market risk capital framework in 2016, the 2017 Reforms recalibrate the Basel II/III CVA framework to be consistent with those revisions. Furthermore, the basic approach is benchmarked to the standardized approach.

Leverage Ratio

BASEL LEVERAGE RATIO

G-SIB LEVERAGE BUFFER

Changes

- Implemented a buffer for G-SIBs equal to 50% of the G-SIB surcharge. Failure to meet the buffer would have similar consequences as failure to meet the G-SIB surcharge (restrictions on distributions and discretionary bonus payments).
- An example of the limitations for a G-SIB with a 1% G-SIB surcharge (.5% G-SIB leverage buffer) follows:

CET1 Ratio	Leverage Ratio	Payout Ratio*
4.5% to 5.375%	3% to 3.125%	100%
>5.375% - 6.25%	>3.125% - 3.25%	80%
>6.25% - 7.125%	>3.25% - 3.375%	60%
>7.125% - 8%	>3.375% - 3.5%	40%
>8%	>3.5%	0%

Observations

- The U.S. already has the eSLR (flat 2% buffer for BHCs and 3% for IDIs).

*percentage of earnings that must be retained and cannot be applied to distributions and discretionary bonus payments

BASEL LEVERAGE RATIO

Revisions to the Treatment of Derivative Exposures

Changes

- Given the changes that the Basel Committee made to the standardized approach to counterparty credit risk (SA-CCR), the Basel Committee sought to make conforming changes to the leverage ratio exposure measure. Exposure = 1.4 * (RC + PFE) (as calculated under SA-CCR).
- Collateral received may not be netted against derivative exposures, regardless of whether or not netting is permitted under accounting or risk-based capital standards.
  - This necessitates a gross-up where balance sheet netting has occurred.
- Cash VM that meets certain stringent conditions may reduce the replacement cost of a derivative exposure in the exposure measure.

Observations

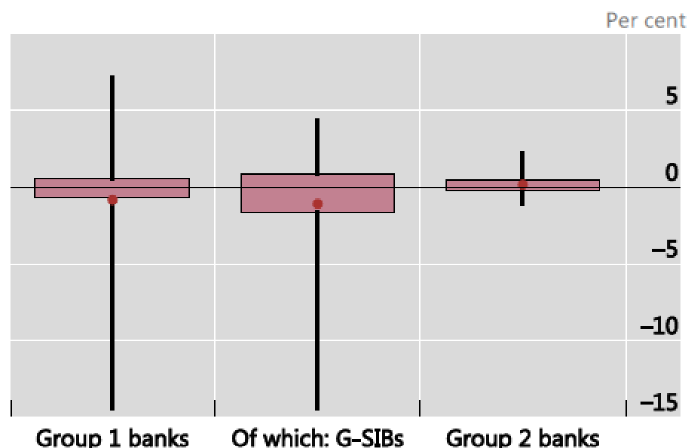
- Under SA-CCR, the maturity factor for margined trades can be adjusted to take into account the shorter time horizons, which can result in significant reductions in PFE.
- The Basel Committee continues to review the effect of the leverage ratio on client clearing and clearing members' business models.
- Implementation in the U.S. will depend on U.S. implementation of SA-CCR.

INDUSTRY IMPACT

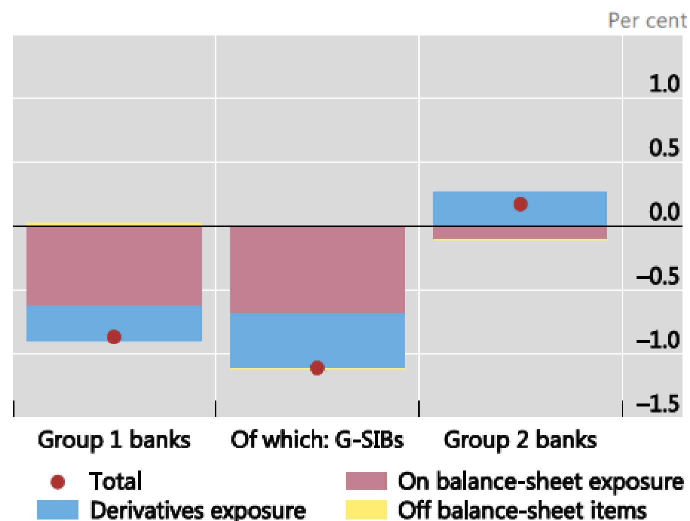
Results of QIS; Impact Due to Revisions to Exposure Measure

Changes in leverage ratio MRC due to revisions to the exposure measure — Graph 17

Distribution of changes[1]



Breakdown by exposure component



[1] The median value is represented by a horizontal line, with 50% of the values falling in the 25th to 75th percentile range shown by the box. The upper and lower end points of the vertical lines generally show the range of the entire sample. The dots represent weighted averages.

Source: Basel Committee on Banking Supervision. See also Table B.17 and Table B.18.

- **Overview of Impacts**. The average impact in leverage ratio MRC for Group 1 banks was -0.9%, with a larger impact for G-SIBs (driven primarily by changes in the amendments to exposure measure for derivatives). Group 2 banks saw an average of a 0.2% increase.

CONTACT INFORMATION

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gjlyons@debevoise.com

REGIONAL LEGAL AND REGULATORY ISSUES

- Part I – MiFID 2
- Part II – SFTR
- Part III – BRRD and Resolution Stays
- Part IV – Regional Regulatory Updates

CLIFFORD
CHANCE

Part I – MiFID 2

CLIFFORD CHANCE

MIFID 2 – OVERVIEW

- » Introduction
- » Trading obligation (equities & derivatives)
- » Transaction reporting
- » Algorithmic trading
- » Regulatory powers

CLIFFORD CHANCE

SCOPE AND APPLICATION

INVESTMENT FIRMS

- Portfolio managers
- Managed accounts
- UCITS and AIFM delegation arrangements
- UCITS management entities and AIFMs carrying on broader activities

APPLICATION OUTSIDE OF INVESTMENT FIRMS

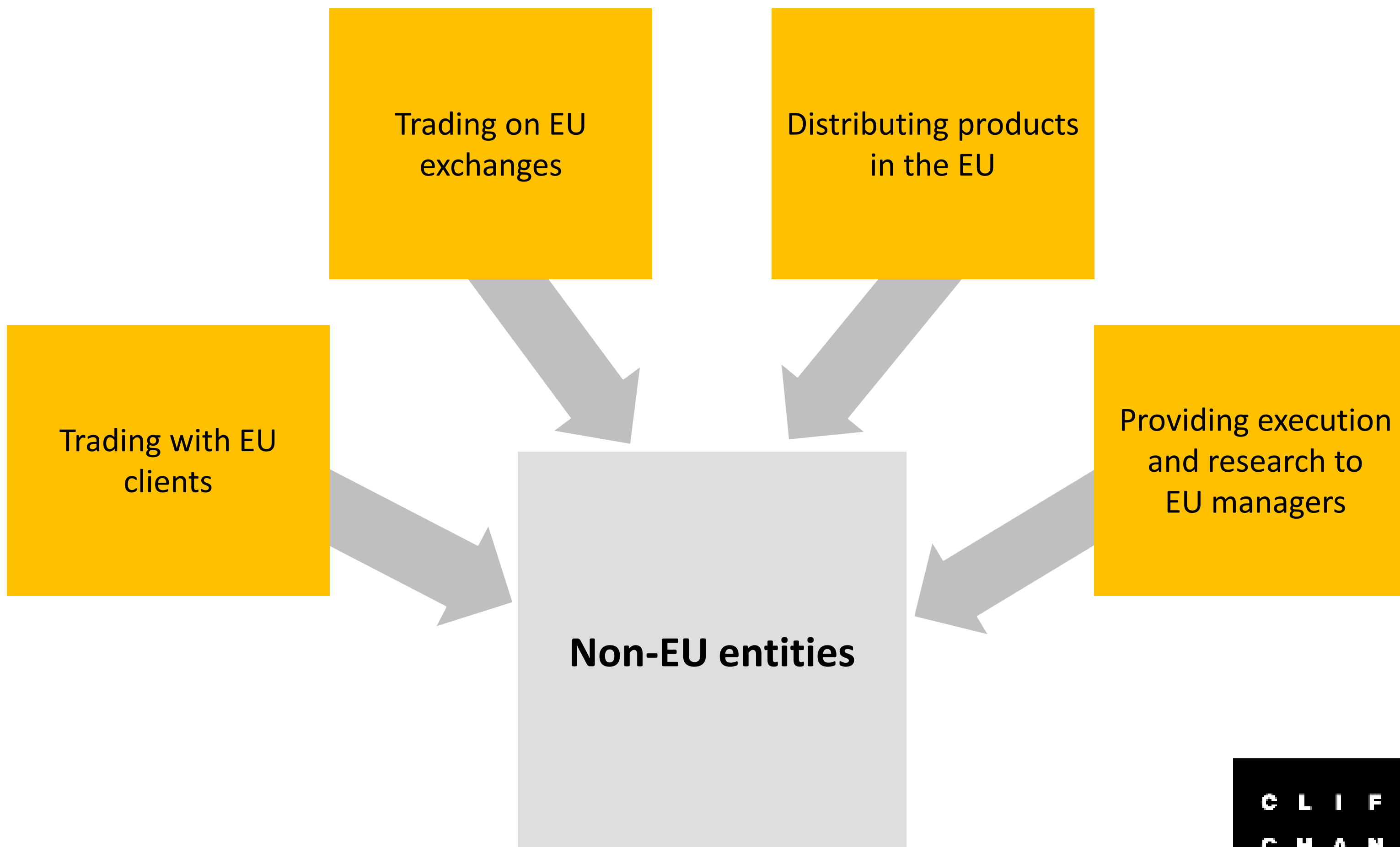
- Position limits
- Trading obligation

INDIRECT APPLICATION

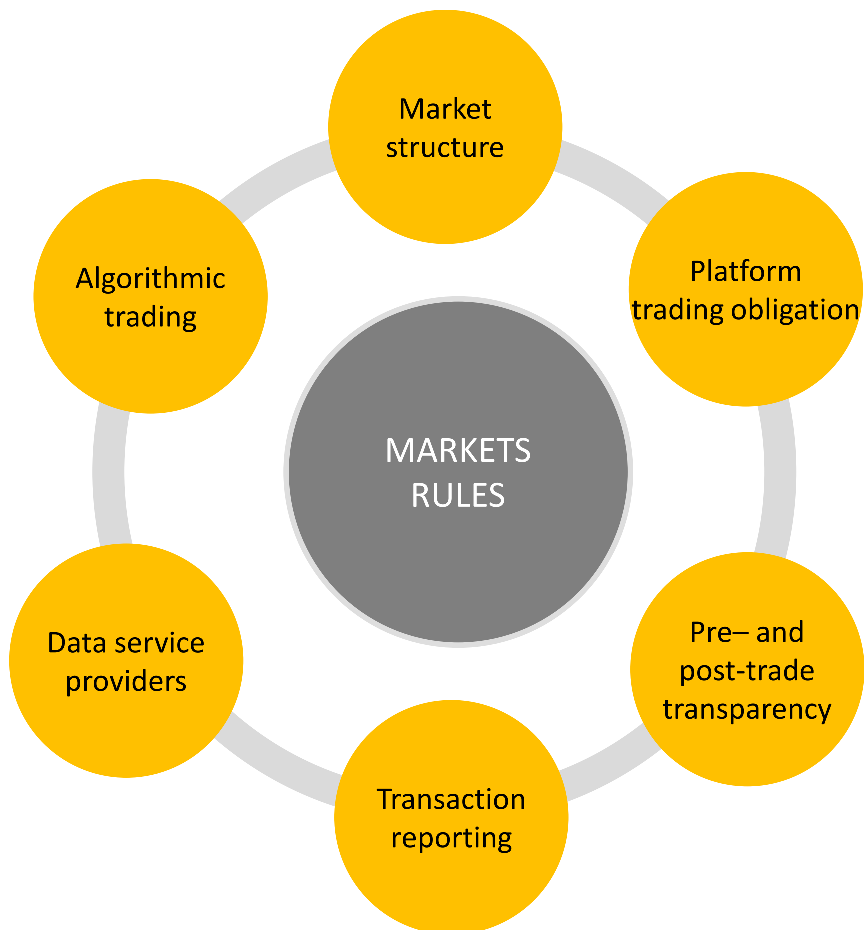
- Buy-side will be affected by changes in rule for sell-side
- Product governance
- Product intervention
- Transparency requirements

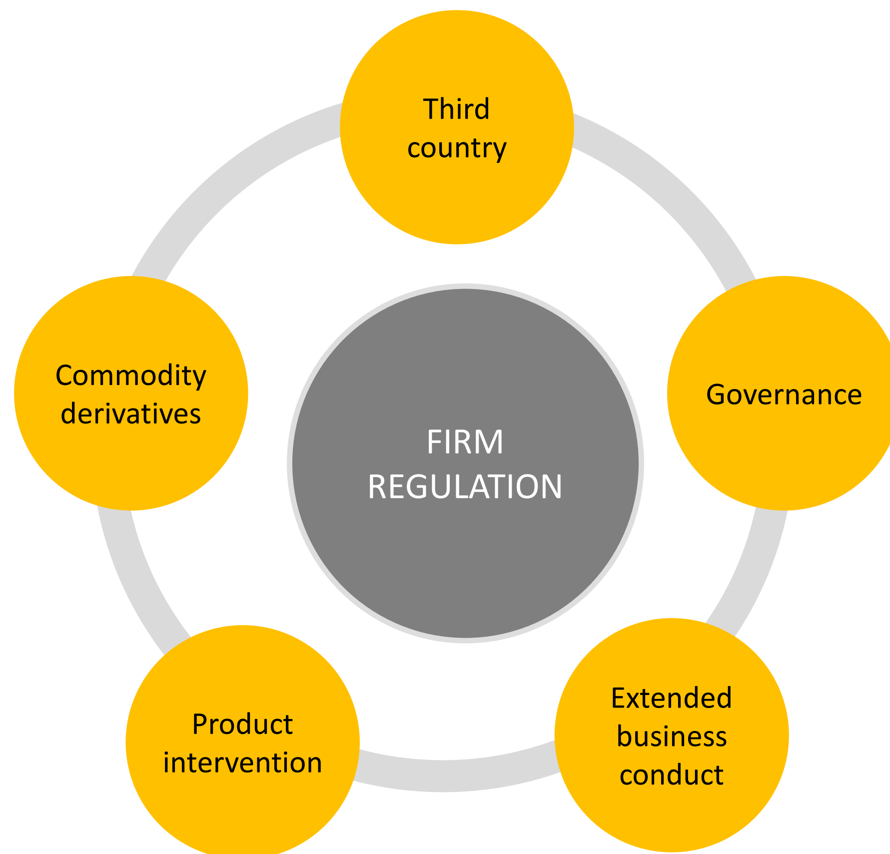
CLIFFORD CHANCE

IS MIFID2 RELEVANT TO ME?



WIDE RANGING CHANGES TO EXISTING RULES





CLIFFORD CHANCE

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.

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.

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.

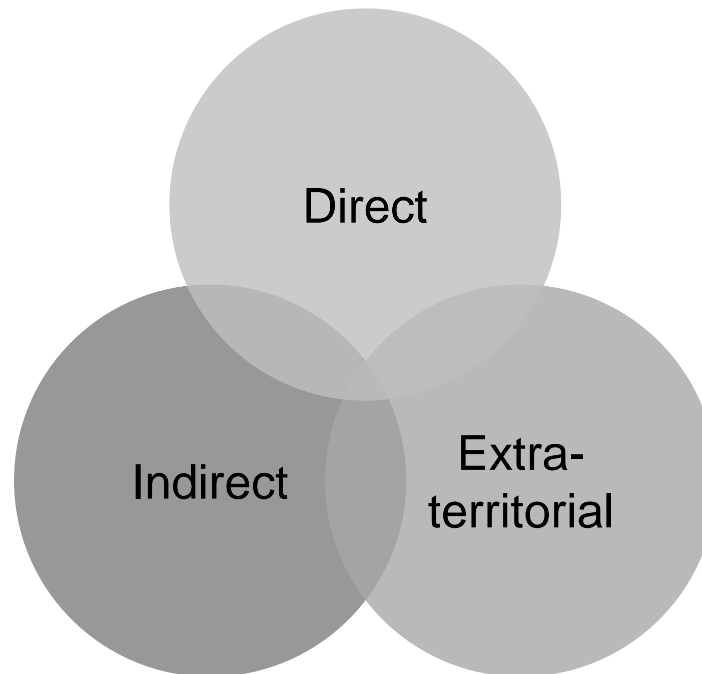
Third countries

- Limited attempt to harmonise regime for access to EU markets by third country firms.

CLIFFORD CHANCE

SCOPE AND APPLICATION

EU broker-dealers and banks



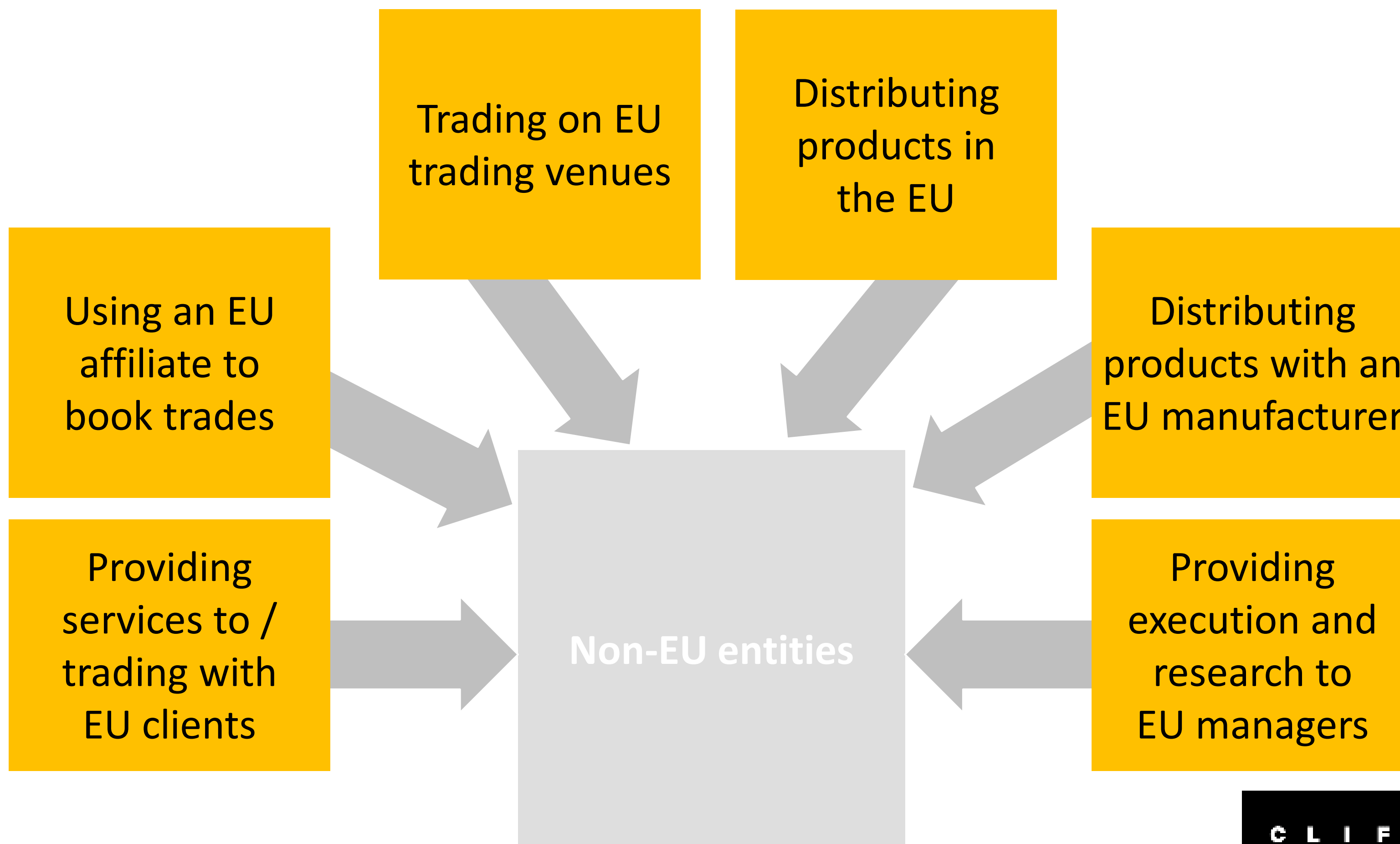
What is your European footprint?

Commodity position limits

Derivatives trading obligation ("EMIR plus")

CLIFFORD CHANCE

WHAT IS YOUR EUROPEAN FOOTPRINT?



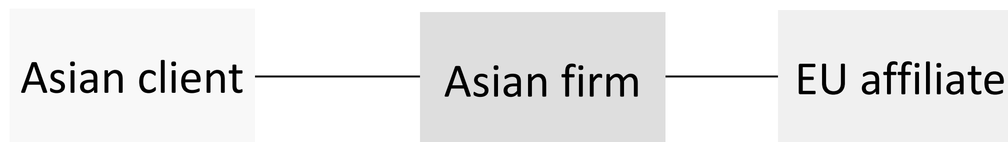
CLIFFORD CHANCE

KEY TRIGGERS: IDENTIFYING EU CLIENTS AND EU AFFILIATES

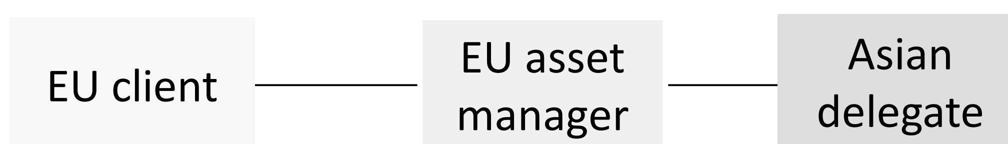
1. Providing services to an EU client

2. Booking trades via an EU affiliate

3. Back-to-back booking with an EU affiliate



4. EU asset manager delegating to an Asian manager



TRADING OBLIGATION FOR EQUITIES

No investment firm may undertake trades in shares unless that trade takes place:

- on an RM
- on an MTF
- with an SI
- on an equivalent third country trading venue

Applies to all shares "admitted to trading on a regulated market or traded on an RM or MTF" unless the trades are:

- non-systematic, ad-hoc, irregular and infrequent, or
- carried out between eligible and/or professional counterparties and do not contribute to the price discovery process.
- ESMA mandated to develop RTS to specify characteristics of non-contributing exemption

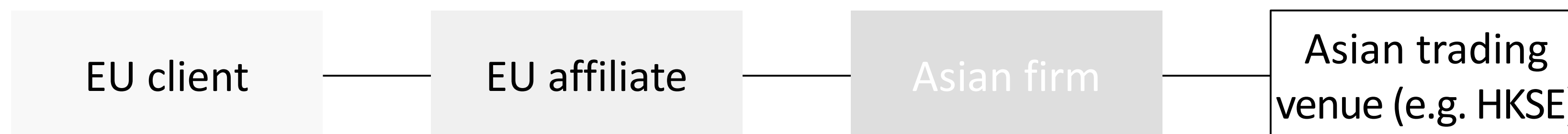
The particular problem of "international equities" and Article 23

- The breadth of "shares" caught by the Article 23 trading obligation is not limited to "EU shares"
- Even if currently not traded on venue, how will firms be able to monitor this?
- Are there any solutions to the problem?
  - Interpretational
  - Structural
  - Equivalent third country trading venues

CLIFFORD CHANCE

TRADING OBLIGATION FOR EQUITIES

Dual-listed securities and execution considerations



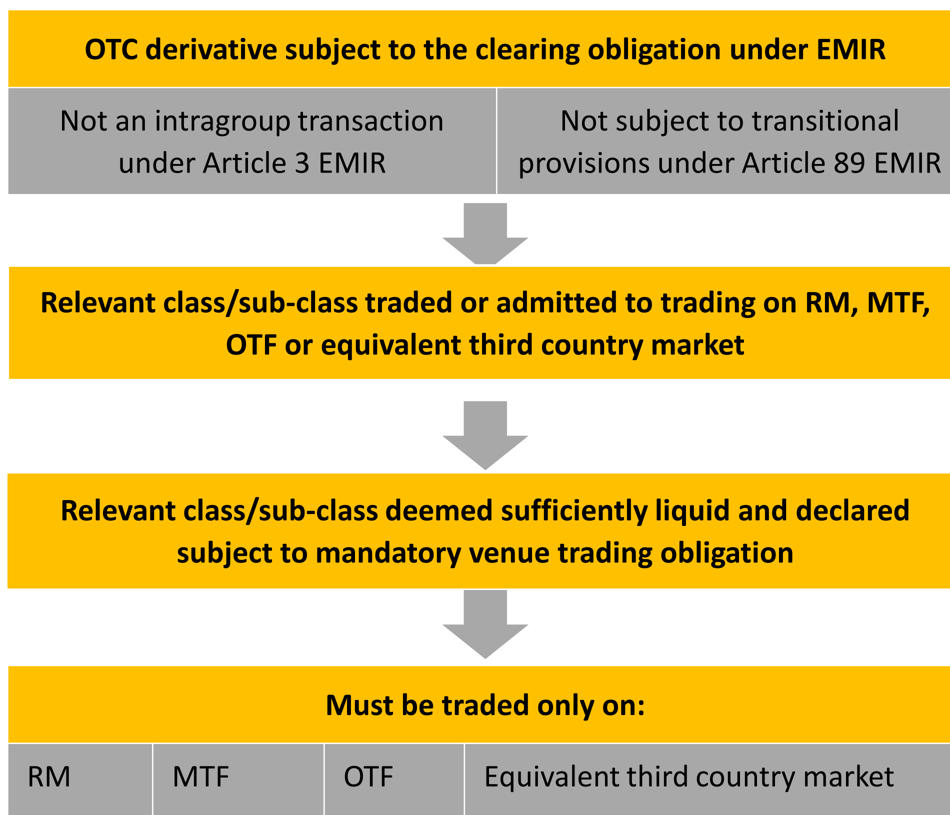
Question: will the mandatory trading obligation be satisfied where actual execution occurs through a back-to-back trade with an Asian firm on an Asian trading venue?

- If the transactions are treated as separate bilateral transactions, may still be non-compliant. But:
  - this would appear to prohibit riskless principal trading for equities subject to Article 23 MiFIR
  - investment firms would need to become members of a large number of stock exchanges
- Instead, the reference to "undertake" could be read as different from "execute", so that a chain of back-to-back transactions:
  - would be treated as a single "trade" (similar to mandatory clearing under EMIR)
  - would be compliant with Article 23 MiFIR, as long as ultimate execution takes place on an EU or equivalent third country trading venue
- Asian trading venue would need to be deemed "equivalent"

CLIFFORD CHANCE

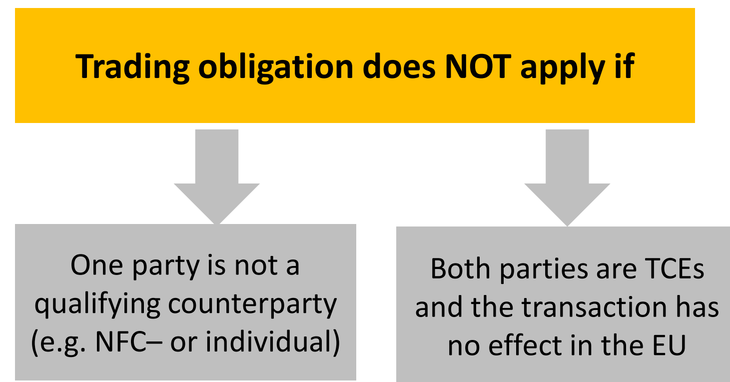
TRADING OBLIGATION FOR DERIVATIVES

Like the clearing obligation in EMIR, the derivatives trading obligation applies to financial and non-financial counterparties, including counterparties outside the EU



Scope: qualifying counterparties

- Both counterparties must be 'qualifying counterparties'
  - Financial counterparties (FC)
  - Non-financial counterparties above the clearing threshold (NFC+)
  - A third country entity (TCE) that would be FC or NFC+ if established in the EU
  - Two TCEs, if the transaction has 'direct, substantial and foreseeable effect' in the EU



WHY IS TRANSACTION REPORTING MORE DIFFICULT THIS TIME?

Why is it changing?

Purpose of MiFIR transaction reporting

- Market integrity
- To allow regulators to detect and investigate instances of market abuse

To improve quality and consistency of data received

- Technical requirements set out in RTS – harmonised across the EU

What is changing?

More instruments/ transactions within scope

- Instruments traded on MTFs and OTFs as well as instruments admitted to trading on regulated markets
- Instruments where underlying traded on a trading venue or is an index or basket

More information required on transaction reports

- Currently 25 core fields
- Going up to 65 fields
- New fields include short sale and pre-trade waiver flags

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TRANSPARENCY RULES FOR NON-EQUITIES

Scope

- Bonds and structured products
- Emission allowances
- Derivatives traded on a trading venue
- Firms, SIs, OTFs, MTFs, RMs.

Exemptions

- Pre-trade waivers
- Post-trade deferral

Key variables

- Liquidity definition (Art 2(1)(17a) MiFIR)
- ESMA RTS to calibrate waiver and deferral regimes

CLIFFORD CHANCE

ALGORITHMIC TRADING

What is algorithmic trading?

- Algorithmic trading
  - trading in financial instruments
  - computer algorithm automatically determines individual parameters of orders
  - with limited or no human intervention
- High frequency algorithmic trading techniques
- Direct electronic access (DMA / sponsored access)

What are the obligations?

- Systems and controls, user testing, kill functionality, business continuity
- Notify competent authorities (competent authorities may request further details)
- Record keeping obligations
- Liquidity provision obligation where market making
- Effective systems and controls regarding DMA / sponsored access

Potential indirect impact

- Asian firm engaging in algorithmic trading on an EU trading venue
- Asian firm accessing EU trading venue via DEA
- EU firm / affiliate using an algorithm developed by Asian firm

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THE IMPACT OF MIFID II ON SECURITIES FINANCING MARKETS

- MiFID2 impacts most aspects of a firms activity
- Securities finance activity does not always fit the requirements easily
- Firms need to make ‘judgment calls’ to interpret the rules in a securities lending context
- Areas that specifically impact securities finance include:
  - Client classification
  - Best Execution
  - Order record Keeping
  - Transaction reporting
  - Client reporting

Part II – SFTR

CLIFFORD CHANCE

SFTR IN THE CONTEXT OF SHADOW BANKING REGULATION

FSB Policies

- 2017 - Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities
- 2015 - Regulatory framework for haircuts on non-centrally cleared securities financing transactions
- 2013 - Policy framework for addressing shadow banking risks in securities lending and repos
- 2013 - Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities

European Commission Workstream

- Green Paper on Shadow Banking - March 2012
- Communication on Shadow Banking - September 2013
- Regulation on Money Market Funds – applies from July 2018
- Regulation on reporting and transparency of securities financing transactions - applied from January 2016

Key FSB Recommendations

Include

- Disclosures on re-hypothecation
- Reporting requirements of fund managers towards end investors
- Regulatory reporting
- Minimum standards for cash collateral reinvestment by non-banks
- Harmonisation of client asset rules on re-hypothecation
- Minimum standards for collateral valuation and management
- Review of use of CCPs for inter-dealer repos

FSB Papers

- 2013 - An Overview of Policy Recommendations for Shadow Banking
- 2015 - Transforming Shadow Banking into Resilient Market-based Finance: An Overview of Progress
- 2017 - Chair's letter to G20 Finance Ministers and Central Bank Governors outlining progress
- 2017 - FSB Assessment of shadow banking activities, risks and the adequacy of post-crisis policy tools to address financial stability concerns
- 2017 - Second phase of the G20 Data Gaps Initiative (DGI-2): Second Progress Report

CLIFFORD CHANCE

SFTR OVERVIEW

– EU Regulation on transparency of securities financing transactions (SFTs) and of reuse and amending Regulation (EU) No. 648/2012 (EMIR)

Key provisions

- Transparency of rights of reuse of financial collateral through disclosure to counterparties
- Transparency by collective investment schemes of use of SFTs and total return swaps through disclosure to investors
- Transparency of SFTs to regulators through reporting to trade repositories

SFTR has broad application:

- Applies to financial and non-financial counterparties and fund managers (with extraterritorial scope)
- Covers broad range of transactions, not just securities financing, including taking collateral, total return swaps, some commodities finance and margin loans
- Very limited exemptions e.g. no exemption for intra-group transactions

Amends EMIR definition of OTC derivatives to make it easier to recognise non-EU markets as equivalent to regulated markets

The SFTR is in force from 12 January 2016

- Regulation (EU) 2015/2365 published in the Official Journal on 23 December 2015
- Phased implementation - transitional provisions apply
- Detailed rules in Level 2

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LEVEL 2 – RTS AND ITS

Article 4 Reporting obligation and safeguarding in respect of SFTs

ESMA to develop draft RTS specifying the details of the reports to be submitted to a trade repository or to ESMA (if no trade repository available) and draft ITS specifying the format and frequency of the reports for different types of SFTs.

Submitted on 31 March 2017. Awaiting endorsement by the Commission.

Article 13 Transparency of collective investment undertakings in periodical reports (optional)

ESMA may, taking into account existing requirements under the UCITS and AIFMD Directives as well as evolving market practices, develop draft RTS further specifying the content of Section A of the Annex in order to ensure uniform disclosure of data and take account of the specificities of different types of SFTs and total return swaps.

No specified timeline

Article 5 Registration of a trade repository

ESMA to develop draft RTS on the procedures for registration with a trade repository and draft ITS on trade repository registration.

Submitted on 31 March 2017. Awaiting endorsement by the Commission

Article 14 Transparency of collective investment undertakings in pre-contractual documents (optional)

ESMA may, taking into account existing requirements under the UCITS and AIFMD Directives, develop draft RTS further specifying the content of Section B of the Annex in order to reflect evolving market practices or to ensure uniform disclosure of data.

No specified timeline

Article 12 Transparency and availability of data held in a trade repository

ESMA to develop draft RTS on the publication by a trade repository of the aggregate positions of the SFTs reported to it and the collection and maintenance of SFT trade details to be made accessible to various regulatory bodies.

Submitted on 31 March 2017. Awaiting endorsement by the Commission

Article 25 Exchange of information with ESMA

ESMA to develop draft ITS to determine the procedures and forms for the exchange of information on sanctions and fines between competent authorities and ESMA

Submitted on 31 March 2017. Awaiting endorsement by the Commission.

LEVEL 2: WORK ON RTS/ITS ON REPORTING AND REGISTRATION OF TRADE REPOSITORIES

- ESMA draft RTS and ITS under SFTR issued 30 September 2016
- Sets out proposals for the reporting framework under SFTR and the registration requirements for trade repositories
- Builds on EMIR reporting model

Reporting proposals relate to:

- The use of internationally agreed reporting standards, SFTR reporting logic and the main structure of an SFT reports
- Requirements on transparency, aggregation and comparison of data
- The access levels for different competent authorities

Next Steps

- Consultation closed 30 November 2016.
- Final draft RTS/ITS submitted to the Commission on 31 March 2017. Awaiting endorsement
- Reporting will commence 12,15,18 or 21 months after the date the RTS come into force

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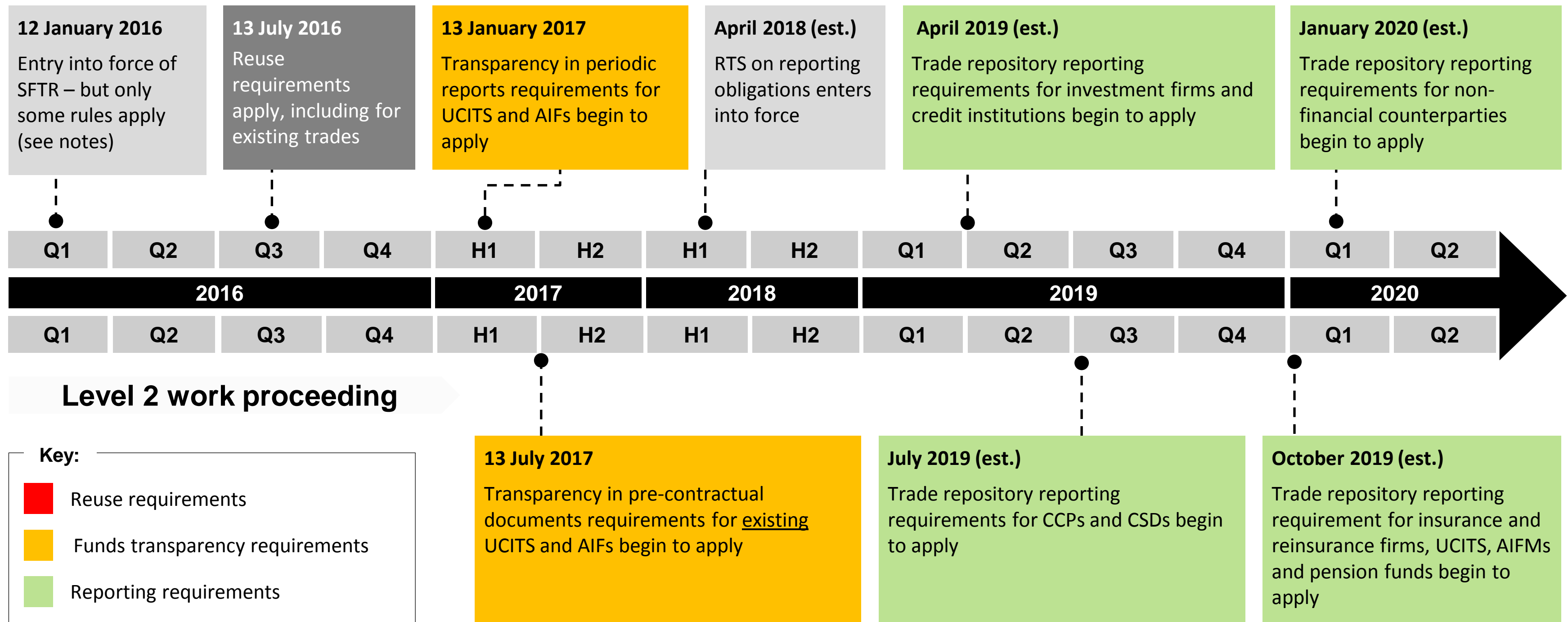
SFTR – ILLUSTRATIVE IMPLEMENTATION TIMELINE



Notes:

- The SFTR was published in the OJ on 23 December 2015
- Record-keeping requirement for SFTs (Art. 4(4)), transparency requirements for pre-contractual documents for new funds (Art. 14) and the obligation to establish internal procedures for reporting breaches (Art. 24(3)) apply from date SFTR comes into force i.e. 12 January 2016
- Reuse requirements (Art. 15) apply from 13 July 2016, 6 months after date SFTR came into force, with retroactive effect for existing collateral arrangements
- Funds transparency requirements apply from 13 January 2017 (Art. 13) and, for existing funds, 13 July 2017 (Art. 14)
- Reporting requirements (Art. 4) apply from 12, 15, 18 and 21 months after the RTS on Art. 4 come into force (depending on counterparty category)
- ESMA delivered draft RTS/ITS on Art. 4 on 31 March 2017 which are awaiting endorsement by the Commission
- *Illustrative reporting dates assume that the RTS come into force in April 2018, meaning that the phase-in of the reporting requirements starts in April 2019.*
- Dates could vary e.g. could be later if the Commission amends ESMA's draft RTS or the Parliament or the Council object to the RTS

REPORTS AND REVIEW – TIMINGS ARTICLE 29

- 4 October 2016
  - » ESMA issued report on shadow banking, leverage and pro-cyclicality
- 19 October 2017
  - » The Commission reports on progress in international efforts to mitigate the risks associated with SFTs, including the FSB recommendations for haircuts on non-centrally cleared SFTs
- 2019
  - » ESMA to publish first annual report on aggregate SFT volumes by counterparty type and transaction, based on data reported to trade repositories (date not specified in Level 1 text)
- Q1 2021? (24 months from reporting start date)
  - » ESMA to report on efficiency of reporting obligation, taking into account the appropriateness of single sided reporting (and every three years thereafter or earlier if material developments)
- Q1 2022? (36 months from reporting start date)
  - » The Commission to report on the effectiveness, efficiency and proportionality of the obligations under SFTR
- Q3 2022? (39 months from reporting start date)
  - » The Commission to report on supervisory fees charged by ESMA to trade repositories

Part III – BRRD and Resolution Stays

INTRODUCTION

- **Context:** Financial Stability Board pressed for the implementation of statutory special resolution regimes (SSRs) in the wake of the Great Financial Crisis
- **Goal:** Harmonisation of SSRs across the European Economic Area by providing a set of minimum requirements

Preparation

- Recovery and resolution planning
- Resolvability assessments
- Regulators' powers to address or remove impediments
- Intra-group financial support agreements

Early Intervention

- Regulators' powers to direct remedial action
- Further powers triggered by failure to meet or likely failure to meet authorisation conditions
- Power to appoint a temporary administrator

Resolution

- Harmonised objectives and triggers
- Common set of resolution tools: sale of business, bridge bank, asset separation, bail-in, resolution stays
- Government stabilisation tools
- European system of financing arrangements
- Cross-border recognition framework
- Depositor preference
- Power to appoint special manager

RESOLUTION STAYS

Resolution authorities can impose stays on all “contracts” entered into with an institution in resolution and, in certain instances, its subsidiaries and affiliates

- Article 68 – General Stay: override of the exercise of termination rights that arise as a result of the exercise of authority under BRRD
- Article 69 – Suspension of Payment Obligations: one-business-day suspension on the payment or delivery obligations under any contract to which an entity in resolution is a party
- Article 70 – Suspension of Security Interests: one-business-day suspension on the rights of a secured party to enforce security interests in relation to any assets of the institution under resolution
- Article 71 – Suspension of Termination Rights: one-business-day suspension of “termination rights” (broadly defined and includes rights to terminate, accelerate, close out, set-off or net obligations or any similar provisions)

CROSS-BORDER ENFORCEABILITY

Problem: BRRD only applies to EEA member states

Solutions:

- Legislative: changing the law in third-country jurisdictions to ensure mutual recognition of resolution stays, and ensuring that the authority in the third-country jurisdiction takes supportive and consistent resolution measures
- Contractual: mandating the implementation of contractual arrangements which provide for the recognition in financial contracts of Temporary Stays or restrictions on early termination rights (adopted by UK Prudential Regulation Authority's final rules (November 2015)

ISDA UNIVERSAL RESOLUTION STAY PROTOCOL

Features:

- Universal approach – applies to
  - Identified Regimes – France, Germany, Japan, Switzerland, UK, USA
  - Protocol-eligible Regimes - FSB jurisdictions and any jurisdiction in which a current or future G-SIB is headquartered (via updated Country Annexes)
- Limited to ISDA Master Agreements / master agreements by SFT Trade Associations (e.g. Global Master Repurchase Agreement), and related credit support arrangements
- Amends all agreements between adherents (266 adherents as of 21 September 2017) to comply with requirements of SRRs

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ISDA RESOLUTION STAY JURISDICTIONAL MODULAR PROTOCOL

Benefits

- Improved – Universal Resolution was drafted in advance of regulations – may not match all requirements under all jurisdictions
- Wider array of agreements are covered – e.g. UK Module uses PRA Final Rule definition of "third-country law financial arrangements"
- Wider audience – includes buy-side institutions
- Jurisdiction specific – avoids "over-compliance"
- Available modules (as of October 2017):
  - Japan (5 January 2017)
  - Germany (28 June 2016)
  - UK (3 May 2016)

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BRRD2

- 23 November 2016: Commission proposal to amend the BRRD ('BRRD'2)
  - introduce two new moratorium powers
- Effect would be to suspend payment and delivery obligations for up to 5 days (10 days consecutively)
- Strong industry concerns about the impact of new moratoria
- Potential adverse impact on liquidity in securities lending markets

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Part IV – Regional Regulatory Updates

CLIFFORD CHANCE

CHINA

- China Securities Regulatory Commission (CSRC) consultation
- Collaboration with Hong Kong on new Bond Connect
- ASIFMA report on capital markets

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HONG KONG

- Securities and Futures Commission (SFC) report on securities market
- Investor identification regime for Stock Connect
- SFC thematic review of prime services and related equity derivatives activities
- Illustrative examples on the Short Selling Order Flagging Requirements
- SFC pilot test of the Short Position Reporting Service

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INDIA

- Securities and Exchange Board of India (SEBI) introduced amendments to SLB framework (tenure)
- National Securities Clearing Corporation Ltd. (NSCCL) introduced discounts on transaction charges for the SLB scheme

INDONESIA

- Financial Services Authority of Indonesia (OJK) introduced new financial information service system (*Sistem Layanan Informasi Keuangan*)
- OJK introduced new system for electronic registration of Registration Statements in the capital markets sector.
- Cooperation with Indonesia in areas of regulation, supervision and law enforcement, and consumer protection in the financial services sector

JAPAN

- Tokyo Stock Exchange (TSE) announced joint plan to shorten the stock trading settlement cycle
- Financial Services Agency of Japan (JFSA) published draft amendments to the 2017 amendment to the Financial Instruments and Exchange Act
- Japan Securities Clearing Corporation (JSCC) consulted on draft standards for enhancement of risk management for clearing participant default

KOREA

- Korea Exchange (KRX) implemented FSC's proposed amendments to short selling rules
- Intermediary fees for collateral provision SBL transactions waived for six months
- FSC proposed introduction of an omnibus account for fixed income

MALAYSIA

- Bursa Malaysia introduced an Islamic Securities Selling and Buying – Negotiated Transaction framework
- Bursa Malaysia updated the list of eligible securities for SBL
- Securities Commission (SC) published new guidelines for the regulated short selling of corporate bonds
- Bursa Clearing expanded the SBL – Negotiated Transactions framework

SINGAPORE

- Securities and Futures (Amendment) Bill 2016 passed by the Singapore Parliament
- Monetary Authority of Singapore (MAS) consulted on regulations for short selling

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TAIWAN

- Taiwan Stock Exchange (TWSE) issued updated rule to prevent temporary blocking of daily short-sell quota
- Legislative amendments to lower the securities transaction tax on day trading
- Financial Supervisory Commission (FSC) allowed foreign institutional investors to participate in the TWSE SBL
- Trading hours for SBL extended to 09:00 to 15:30
- Total short selling daily volume control limit lifted

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Appendix

STANDARDIZED APPROACH FOR CREDIT RISK

Overview of Changes

Asset Class	Basel II	2017 Basel III	Comments
Banks	20% - 150%	20% - 150% (ECRA) 30% - 150% (SCRA)	• Lower risk weight for A+ to A- band from 50% to 30%. • Introduction of SCRA as alternative to external ratings.
Banks (Short-Term)	20% - 150%	20% - 150% (ECRA) 20% - 150% (SCRA)	• Lower risk weights for short-term exposures in the middle bands.
Covered Bonds	20% - 150%	10% - 100%	• Previously treated as general corporate exposures. • Less relevant for U.S. banks.
General Corporates	20% - 150%	20% - 150% (ECRA) 65% - 100% (SCRA)	• Introduction of SCRA as alternative to external ratings. • Includes securities firms not treated like banks.
Specialized Lending	20% - 150%	80% - 130% (Issue-rating not available or permitted)	• Previously treated as general corporate exposures. • Divided between project finance and object/commodity finance.
Subordinated Debt, Equity and Other Capital	Varies	100% - 400%	• Previously treated as bank or general corporate exposures.
Retail	75%	45% - 100%	• Distinguishes between revolving and non-revolving regulatory retail). • Introduces the concept of transactors and revolvers within revolving regulatory retail.
Residential Real Estate	35%	20% - 150%	• New framework based on loan-to-value ratios. • Distinguishes between income-producing and non-income producing real estate.
Commercial Real Estate	100%	20% - 150%	• See above. • 150% for commercial ADC.

STANDARDIZED APPROACH FOR CREDIT RISK

Overview of Changes to Credit Conversion Factors

Asset Class	Basel II	2017 Basel III	Comments
Unconditionally Cancellable Commitments	0%	10%	• Potentially significant impact on wide range of credit facilities.
Commitments (other that UCCs)	20% - 50%	40%	• No longer distinguishes between commitments based on original maturity.
NIFs, RUFs and transacting-related contingent items	50%	50%	• No change.
Short-term liquidating trade letters of credit	20%	20%	• No change.
Direct Credit Substitutes and Other	100%	100%	• No change.

INTERNAL RATINGS BASED APPROACHES

Corporate and Bank Exposure: Changes to the F-IRB

Table of Secured LGDs and Haircuts

Type of Collateral	LGDs	Haircut
Eligible financial collateral	0%	Generally determined based on the haircuts applicable under the comprehensive approach.
Eligible Receivables	20%	40%
Eligible residential real estate / commercial real estate	20%	40%
Other eligible physical collateral	25%	40%
Ineligible collateral	N/A	100%

INTERNAL RATINGS BASED APPROACHES

Corporate and Bank Exposures under A-IRB

Table of LGD Floors

Unsecured	Secured
25%	Varying by collateral type: • 0% financial • 10% receivables • 10% commercial or residential real estate • 15% other physical

INTERNAL RATINGS BASED APPROACHES

Retail Exposure Class

Changes

- Introduction of a PD floor of 10 basis points for QRRE revolvers and 5 basis points for all other retail exposures.
- Limits on the ability to estimate CCFs (limited to revolving commitments to extend credit, purchase assets or issue credit substitutes, provided the exposures are not subject to a 100% CCF under the F-IRB).

Observations

- Currently, the U.S. imposes a 10 basis point floor for residential mortgage exposures (except for certain U.S. government-backed exposures).
- The imposition of an EAD floor based in part on standardized approach CCFs could result in significantly higher EADs for unconditionally cancelable commitments, notwithstanding the ability to estimate CCFs for revolving commitments to extend credit.

INTERNAL RATINGS BASED APPROACHES

Equity Exposure Class

Changes

- In the Basel Committee's view, it is unlikely that banks will have specific knowledge concerning the issuer of equity securities (particularly publicly traded equities) beyond that which is available to the public.
- The Basel Committee reasoned that if banks are limited to the same set of information as the public, it would be difficult to justify capital requirements for such exposure varying between banks.
- As a result, the 2017 Reforms remove the ability to use any IRB approach with respect to any equity exposure in the banking book. Such exposure would be measured solely under the standardized approach for credit risk.

INTERNAL RATINGS BASED APPROACHES

Credit Risk Mitigation

Changes

- F-IRB Approaches. Currently, the Basel II/III F-IRB permits banks to recognize the effects of guarantees and credit derivatives by either replacing the PD of the exposure with (1) the PD appropriate to the guarantor's borrower grade or (2) some grade between the underlying obligor ant the guarantor's borrower grade. The 2017 Reforms remove the latter approach.
- Double Default. The Basel II/III framework permits banks that use the IRB approaches to apply "double default" treatment in respect of certain credit derivatives and similar products. The 2017 Reforms eliminate the double default approach due to its perceived complexity and lack of use by banks.
- Conditional Guarantees. Currently, under the Basel II/III A-IRB approach, conditional guarantees may be recognized if the bank can demonstrate their effectiveness. The 2017 Reforms prohibit conditional guarantees, but clarify that for purposes of estimating EAD under the A-IRB, guarantees that only cover loss remaining after a bank has first pursued the original obligor for payment and has completed the work-out process will be regarded as unconditional, so long as the guarantee does not contain any clause outside the direct control of the lending bank that could prevent the protection seller from being obliged to pay.

INTERNAL RATINGS BASED APPROACHES

Credit Risk Mitigation

Changes

- Removing Option to Estimate Haircuts. Consistent with the revisions to the standardized approach, the 2017 Reforms remove the option from the F-IRB approach to use own estimates of haircuts.
- VaR Models. Given that the standardized approach no longer permits banks to use a VaR model to determine exposure amounts for securities financing transactions, the 2017 Reforms reintroduce the VaR model approach into the IRB approaches.
- Nth-to-Default Credit Derivatives. Pursuant to the 2017 Reforms, banks may recognize the risk mitigating effects of first-to-default credit derivatives under the A-IRB approach, but may not recognize the risk mitigating effects of second-to-default or more generally nth-to-default credit derivatives. Consistent with the standardized approach, banks that use the F-IRB approach for an asset class may not recognize the risk mitigating effects of any nth-to-default credit derivative.

STANDARDIZED CAPITAL FLOOR

Implementation Timeline

Date	Output floor calibration
1/1/2022	50%
1/1/2023	55%
1/1/2024	60%
1/1/2025	65%
1/1/2026	70%
1/1/2027	72.5%

BASEL LEVERAGE RATIO

Treatment of Regular-Way Purchases and Sales of Financial Assets

Changes

- Banks that use trade date accounting (trades accounted for on the trade date) must reverse out any offsetting between cash receivables for unsettled sales and cash payables for unsettled purchases, but may offset if two conditions are met:
  - the financial assets bought and sold are associated with payables and receivables fair valued through income and included in the bank's trading book.
  - The financial assets are settled on a DvP basis.

- Banks that use settlement date accounting (trades accounted for on the settlement date) must subject those items to the requirements for off-balance sheet items and a 100% CCF, and allow deductions from the exposure amount for provisions that have decreased tier 1 capital.
  - The 100% CCF is subject to an offset for commitments to pay and cash to be received, provided the conditions for trade date accounting offset are met.

Observations

- The changes are meant to ensure that the accounting election does not affect the leverage ratio exposure measure.
- The Basel Committee's inherent preference is for trade date accounting. They are (were) of the view that settlement date accounting does not accurately reflect the risks associated with assets purchased but not settled nor with cash receivables for assets pending settlement.

BASEL LEVERAGE RATIO

Treatment of Provisions

Changes

- Under the existing Basel III leverage ratio framework, on balance sheet amounts must not be reduced by general provisions (specific provisions and accounting valuation adjustments are permitted). Similarly, notional amounts could not reflect any general or specific provisions.
- The 2017 Reforms now allow both general and specific provisions that have decreased tier 1 capital to reduce the Basel III leverage ratio exposure measure.
  - Off-balance sheet items may be reduced by the amount of any associated specific and general provisions provided that they have decreased tier 1 capital.
  - In calculating off-balance sheet items, specific and general provisions would be deducted after application of the CCF.

Observations

- The impact on the U.S. is unclear.

BASEL LEVERAGE RATIO

Other Changes

Changes

- Revisions to the CCFs to conform with revisions to the standardized approach.
- Incorporation of responses to FAQs (e.g. clarification that open ended repos do not qualify for netting cash payables and receivables).
- Clarification of the treatment of cash pooling transactions (some notional cash pools can be treated on a net basis).
- Originating banks may exclude securitized exposures from the exposure measure if the securitization meets certain operational requirements.

PASLA 2018 – REGULATORY UPDATES IN ASIA

- China
  - The China Securities Regulatory Commission (CSRC) issued a consultation draft of the amended Measures on the Supervision and Administration of Credibility of Securities and Futures Markets [December 2017]
  - The People's Bank of China (PBOC) and the Hong Kong Monetary Authority (HKMA) collaborated on a new Bond Connect system to enable overseas investors to make investments in the Chinese interbank bond market through the infrastructure connection between China and Hong Kong in terms of trading, custody and settlement [July 2017]
  - ASIFMA released a report entitled "*China's Capital Markets: Navigating the Road Ahead*" that, amongst other things, advocated the continued development of the Chinese capital markets by the adoption of global standards on short selling. The report noted that short selling is not prohibited in China, but is currently cumbersome and impracticable because of inefficiencies in the SBL market [March 2017]

PASLA 2018 – REGULATORY UPDATES IN ASIA

- Hong Kong
  - The Securities and Futures Commission (SFC) published its review of the global and local securities market in 2017. The report featured Stock Connect Trading and the expansion of the Short Position Reporting (SPR) Regime [January 2018]
  - The SFC and the China Securities Regulatory Commission (CSRC) announced a proposal to introduce an investor identification regime for Northbound trading under Stock Connect by the third quarter of 2018 [November 2017]
  - The SFC commenced a thematic review of prime services and related equity derivatives activities in Hong Kong. The key objectives of this thematic review were to identify potential conduct issues arising from practices adopted by prime brokers, assess internal controls that are in place, and to provide guidance on how risks can be managed [October 2017]
  - The Stock Exchange of Hong Kong Limited (HKEX) issued a set of illustrative examples on the Short Selling Order Flagging Requirements under the Rules of the Exchange that set out various scenarios commonly faced by exchange participants [September 2017]
  - The SFC operated a pilot test of its Short Position Reporting Service from 11 January to 10 March 2017. This pilot test facilitated the roll out of the expanded short position reporting requirements from 15 March 2017. The SFC also published a new user guide and frequently asked questions on 7 November 2017 to reflect the expanded requirements [January, March, November 2017]

PASLA 2018 – REGULATORY UPDATES IN ASIA

- India
  - The Securities and Exchange Board of India (SEBI) introduced amendments to the SLB framework that provided for revisions to the tenure of contracts, position limits, and treatment of corporate actions during the tenure of SLB contracts, and the rollover facility. The amendments to the SLB framework were reflected by the National Stock Exchange (NSE) in a series of amendments to its SLB scheme that took effect on 1 January 2018 [December 2017]
  - The National Securities Clearing Corporation Ltd. (NSCCL) introduced incentives in the form of discounts on the transaction charges that are levied on a monthly basis on transactions executed in the SLB scheme on the NSE [February 2017]

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- Indonesia
  - The Financial Services Authority of Indonesia (OJK) has required all financial services institutions to provide their financial reports through a new financial information service system (*Sistem Layanan Informasi Keuangan* or SLIK). The goal of SLIK is to promote access to financing through the sharing of information among financial services institutions [September 2017]
  - The OJK rolled out a new system for electronic registration of Registration Statements in the capital markets sector. The first phase of the roll out will involve registrations pertaining to public offerings of equities, bonds and sukuks, and shelf registrations of bonds and sukuks. The second phase of the roll out will cover limited public offerings, statements of corporate mergers or acquisitions and statements of tender offerings [May 2017]
  - The OJK signed a memorandum of understanding with Indonesia's Director General of Taxation on cooperation in the areas of regulation, supervision and law enforcement, and consumer protection in the financial services sector [March 2017]

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- Japan
  - The Tokyo Stock Exchange (TSE) and other bourses announced a joint plan to shorten the stock trading settlement cycle from T+3 to T+2 by April or May 2019. This plan was based on a report by a working group set up by the Japan Securities Dealers Association (JSDA) [October 2017]
  - The Financial Services Agency of Japan (JFSA) published draft amendments to the 2017 amendment to the Financial Instruments and Exchange Act, which includes (i) registration requirements for high-speed trading firms engaging in high-speed trading on the Japanese market, (ii) providing flexibility in exchanges' scope of business and investment in foreign exchanges or firms engaging in market-related business and (iii) fair disclosure rules [October 2017]
  - The Japan Securities Clearing Corporation (JSCC) published for public comment draft standards for enhancement of risk management regarding response to default by a clearing participant. These enhancements include the increase of margins and other advance contribution to liquidation fund (or guaranty fund) from clearing members and participants, temporary use of cash in liquidation fund for fund settlement upon clearing participant's default, and rules on disposition of defaulted clearing participant's positions [September 2017]

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- Korea
  - The Korea Exchange (KRX) implemented the Financial Services Commission's (FSC) proposed amendments to short selling rules by amending its business regulations with effect from 27 March 2017. The FSC proposed further amendments that would impose further restrictions on short selling by modifying the criteria for the designation of overheated short sell stock and strengthening penalties against violators. These further amendments took effect from 25 September 2017 [September 2017]
  - The Korea Securities Depository (KSD) and the Korea Securities Finance Corporation (KSFC) confirmed that the intermediary fees for collateral provision SBL transactions were waived for six months between 31 March to 30 September 2017 [April 2017]
  - The FSC proposed the introduction of an omnibus account for fixed income that will utilize the special nominee account that is already in place for equities [March 2017]

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- Malaysia
  - Bursa Malaysia introduced an Islamic Securities Selling and Buying – Negotiated Transaction framework that offers conventional SBL transactions that are structured using Shariah law principles. To implement this new model, amendments to the Rules of Bursa Clearing were introduced with effect from 12 December 2017 [December 2017]
  - Bursa Malaysia updated the list of eligible securities for SBL in July 2017 and January 2018
  - The Securities Commission (SC) published new guidelines for the regulated short selling of corporate bonds, which allow Principal Dealers to conduct regulated short selling of corporate bonds. Bank Negara Malaysia also expanded regulated short selling of Malaysian Government Securities to all resident entities with effect from 2 May 2017 [April 2017]
  - Bursa Clearing expanded the SBL – Negotiated Transactions framework to facilitate the settlement of potential failed trades by allowing Approved SBLNT Borrowers to borrow securities to settle sales where there are insufficient securities to meet delivery obligations as a result of a mistake made in good faith when executing the sale [February 2017]

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- Singapore
  - The Securities and Futures (Amendment) Bill 2016 was passed by the Singapore Parliament on 9 January 2017. Amongst other things, the amendments seek to implement regulatory reforms in over-the-counter derivatives and enhance the credibility and transparency of the capital markets [February 2017]
  - The Monetary Authority of Singapore (MAS) issued a consultation paper on regulations for short selling to enhance transparency on the level of short selling in securities listed on Singapore's approved exchanges [December 2016]

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- Taiwan
  - The Taiwan Stock Exchange (TWSE) issued an updated rule that prevents short-sell brokers from temporarily blocking the daily short-sell quota without justification [June 2017]
  - The Taiwanese government announced legislative amendments to lower the securities transaction tax on day trading from 0.30 percent to 0.15 percent for a temporary period of one year [April 2017]
  - The Financial Supervisory Commission (FSC) relaxed the SBL markets in Taiwan by allowing foreign institutional investors to participate in the TWSE SBL system from 15 March 2017. Prior to this, participation in the TWSE SBL system had been restricted to specific institutional investors such as foreign banks and securities firms. The TWSE announced that it would amend its SBL Rules with effect from 31 July 2017 to give effect to this relaxation [March 2017]
  - The TWSE announced that the trading hours for SBL would be extended to 09:00 to 15:30 with effect from 9 January 2017. The purpose of this extension was to allow foreign institutional investors more time to manage SBL activities after the regular trading hours for equities closed at 13:30 [January 2017]
  - The FSC announced that the total short selling daily volume control limit would be lifted from 20 percent to 30 percent of the average trading volume during the previous 30 business days with effect from 23 February 2017, thereby giving more flexibility to investors to execute their trading strategies [December 2016]