

EU and US financial markets regulatory developments

(January 2014 to present)

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Frankfurt am Main, 6 May 2014

Overview of latest EU legislative developments

- Markets in Financial Instruments Directive (MiFID2) and Markets in Financial Instruments Regulation (MiFIR)
- EMIR 'level 2' acts
- Central Securities Depositories Regulation (CSDR)
- 4th Anti money laundering Directive & Regulation on transfers of accompanying funds
- Market Abuse Regulation (MAR) and Criminal Sanctions and Market Abuse Directive (CSMAD)

Main EC proposals not yet adopted by EP or Council

- Regulation on Banking structures reforms
- Directive on a Financial Transactions Tax
- Directive on Money Market Funds

MiFID2 and MiFIR

- **Agreement was reached on both proposals in the Council in mid February and both were approved by EP in its last plenary session on 15 April 2014.**
- **Aim to improve transparency, efficiency and integrity of EU securities markets and to catch up with market developments.**
- Principally, it extends the scope of MiFID to new types of trading platforms and financial instruments, requiring firms to trade on organised venues, including regulated markets, MTFs controlled by approved market operators or larger investment firms and OTFs for non-equities, **e.g. derivatives relating to currencies** (Annex I section C(4) f.i.).
- Second, it imposes extended disclosure and reporting and requirements on market participants in respect of a wider range of transactions tradeable on a market venue – e.g. OTC derivatives, with limited derogations only.

MiFID2 and MiFIR – cont'd

- Improves other key areas, e.g. better investor protection, conduct of business rules for firms and more transparent commodity derivatives markets; firms doing high frequency and algorithmic trading to have effective systems and controls.
- Third countries whose rules are equivalent to the new EU rules will be able to benefit from the EU passport when their firms provide investment services to professionals.
- **ECB support** - the proposed treatment of central bank transactions was the only matter of concern (now addressed)
- The proposals need to be formally adopted by the EU Council (expected June).
- MiFID2 will apply with effect from 2016.
- MiFIR - bulk of provisions apply after 3 years provided EC delegated acts in place, the rest on day following publication.

Central Securities Depositories Regulation

- On **15 April 2014** the **EU Parliament's** plenary session approved the **EC proposal for a Regulation on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC (CSDR)**
- **Aims** to increase the safety and efficiency of securities settlement and settlement infrastructures (CSDs) in the EU by providing, inter alia:
 - Shorter settlement periods;
 - Deterrent settlement discipline measures (mandatory cash penalties and 'buy-ins' for settlement fails);
 - Strict prudential and conduct of business rules for CSDs;
 - Strict access rights to CSD services;
 - Increased prudential and supervisory requirements for CSDs and other institutions providing banking services ancillary to securities settlement.
- **The regulation still needs to be formally adopted by the EU Council (expected June). Publication is foreseen for the third quarter of 2014.**

EU market infrastructure regulation – recent implementation

- EMIR is in force since 16 Aug 2012
- Standardised and liquid derivatives (e.g. currency swaps, cross-currency swaps and swaptions) to be cleared by authorised CCPs.
- ESMA to draft technical standards (RTS) on the classes of notified OTC derivatives that meet the EMIR criteria for clearing.
- **On 18 March 2014 NASDAQ OMX was the first EU-based CCP to be authorised by EC under EMIR. 3 other CCPs authorised by end April.**
- **As of 12 Feb 2014 obligatory reporting to trade repositories of outstanding derivatives entered into since EMIR adoption.**
- **Reporting standards across Trade Repositories** – ESMA TF and FSB working on uniformity and aggregation issues.
- The EC has also adopted a delegated regulation specifying the rules of procedure when ESMA exercises power to impose fines or periodic penalty payments on trade repositories, including rights of defence for trade repositories subject to a sanctioning procedure.

Anti money laundering and transfer of funds

- The EC proposed 4th Anti money laundering directive (AMLD) and the Regulation on information accompanying transfers of funds (TFR) were adopted by EP in plenary session with (ECON/LIBE) amendments at end **February 2014**
- **Aim** is to prevent the use of the financial system for the purpose of money laundering and terrorist financing
- It applies the **risk-based approach** of the FATF standards.
- It requires firms to have written assessments of their MLD/TF risks, and processes for keeping the assessments up to date
- Obligated entities are not only banks and financial institutions, but also other persons (e.g. prof. advisers, trusts and estate agents);
- Public central registers* to list information on **ultimate beneficial owners** of companies, foundations and trusts (* added by EP).

AMLD and TFR cont'd

- **ECB main concern:** payment systems (e.g. T2S) should not be affected as they are automated - user banks are the obligated entities, **not** the system operators. EP adopted text still mentions systems in the recitals.
- The Council has published latest compromise proposal on 4th AMLD on 25 Feb and on the TFR on 25 March 2014.
- The newly elected Parliament of May will negotiate these texts with the new EC and Council in 2H 2014. The next Council Presidency is expected to re-open both dossiers in June.

Banking structures reform

- **EC proposed Regulation on structural reforms to the EU banking sector**
- **Main aims**
- to contain the problem of “too big to fail”;
- to ban proprietary trading by EU’s largest banks, i.e. those with
 - (a) €30 billion assets AND
 - (b) Trading activities exceeding €70 billion or 10% of assets
- to ensure trading in risky assets is performed by a legal entity separate from that of the deposit taking business;
- new powers on supervisors to impose additional trading restrictions on banks (currency derivatives can be used for risk management if clearable by CPP).
- **Separate EC proposal for regulation on reporting of certain financial transactions (i.e. shadow banking).**

Banking structures reform - contd

- **EC expected time schedule**
- **June 2015:** EP and Council adopt final text of the Regulation.
- **1 January 2016:** EC adopts the required delegated acts for implementation of key provisions.
- **1 July 2016:** publication of the list of covered and derogated banks and on a yearly basis thereafter.
- **1 January 2017:** prohibition on proprietary trading comes into force.
- **1 July 2018:** provisions in relation to the potential separation of trading activities become effective from this date.

UK challenge to FTT

- On 30 April **ECJ dismissed UK claim** that Council Decision 2013/52/EU authorising enhanced cooperation by 11 MS - infringes Article 327 TFEU and customary international law, because
 - it authorises the adoption of an FTT which produces extraterritorial effects;
 - alternatively, it infringes Article 332 TFEU because it authorises the adoption of an FTT which will impose costs on Member States which are not participating in the enhanced cooperation.
- ECJ did not examine substance of UK claim, confining itself to review of whether all conditions for the decision had been met and rejecting arguments as premature (i.e. the principles of taxation and expenditure challenged by UK are not constituent elements of that decision).
- Another review necessary in the context of a subsequent action for annulment, of a measure adopted for the purposes of the implementation of the authorised enhanced cooperation.
- When the proposed **Council Directive** is adopted, **the UK may seek to use the same arguments in an action for annulment against that legal act.**

Market abuse

- On **4 Feb 2013** EP adopted the proposed **Criminal Sanctions and Market Abuse Directive (CSMAD)** after agreement in Council in December. **Market Abuse Regulation (MAR)** proposed in Oct 2011, was agreed in the Council last July and endorsed by EP on **10 Sept 2013**.
- **Aim** to ensure integrity in financial markets and enhance investor protection & confidence.
- CSMAD (i) makes benchmark manipulation a **market abuse offence** in EU alongside insider dealing and (ii) provides a common set of definitions and minimum administrative and criminal sanctions.
- MAR **extends** current definitions of insider dealing and market manipulation and the scope of the market abuse framework to **any** financial instrument admitted to trading on MTF, OTF and OTC (**e.g. currency related derivatives and instruments normally traded on the money markets**) (viz MiFID2, Annex I Section C) as well as to **'spot' commodity contracts**.
- **EU Council is expected to adopt both instruments in June.**

Money market funds

- **On 4 September 2013**, the EC proposed a regulation on Money Market Funds (MMFs).
- **Aims** to create a regulatory framework for MMFs in view of ensuring an increased protection of investors, as well as enhancing financial stability by preventing contagion risk.
- to ensure that the liquidity of the fund (via rules on composition of the portfolio) is adequate to face investor redemption requests and
- to render the structure of MMFs safe enough to withstand adverse market conditions.
- ECB is preparing an opinion; the matter is controversial.
- **The EP is divided on the proposal and has failed so far to vote through the proposal.**
- **The EU Council is expected to open discussions on this proposal in July.**