

## Financial Markets Law Committee (“FMLC”)

### Banking Scoping Forum

Date: Thursday 15 June 2017

Time: 9.00am to 10.30am

Location: Bank of England, Threadneedle Street, London EC2R 8AH



#### **In Attendance:**

Bob Penn (Chair)

Thomas Donegan

Paul Gough

Charles Gray (by dial-in)

Anna Lewis-Martinez

Dorothy Livingston

Tom Lodder

Monica Sah

Julia Smithers Excell

Cleary Gottlieb Steen & Hamilton LLP

Shearman & Sterling LLP

Bank of New York Mellon

Sullivan & Cromwell LLP

Cleary Gottlieb Steen & Hamilton LLP

Herbert Smith Freehills LLP

Barclays Bank plc

Clifford Chance LLP

JP Morgan

Venessa Parekh

Thomas Willett

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#### **Regrets:**

Alex Biles

Leland Goss

Simon Hills

Ian Jameson

John McGrath

Oliver Moullin

Jan Putnis

Mitja Siraj

Stuart Willey

Ashurst LLP

International Capital Market Association

British Bankers' Association

Sumitomo Mitsui Banking Corporation Europe Limited

Sidley Austin LLP

Association for Financial Markets in Europe

Slaughter and May

FIA

White & Case LLP

**Registered Charity Number: 1164902.**

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## Minutes:

### 1. Introduction

1.1. Bob Penn opened the meeting and gave a brief introduction

### 2. Legal uncertainties in the capital requirements regulation provisions on cleared exposures for banks and financial intermediaries. (Thomas Donegan)

2.1. Thomas Donegan set forth two key issues of legal uncertainty in the revisions to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (the “**Capital Requirements Regulation**” or the “**CRR**”) proposed by the E.U. in November 2016.

2.2. The first issue of legal uncertainty raised was concerned with trade exposures for intermediaries using indirect clearing. Mr Donegan highlighted ambiguity as to how and when the 0% capital charge under Article 306(1)(c) of the CRR for exposures became available to intermediaries in "longer chains", such as when providing indirect clearing. This provision is applied to clients, including those offering indirect clearing, under Articles 305(2) and 305(3). However, neither Article 306(1)(c) nor the definition of "bankruptcy remoteness" cater for longer chains, even in the proposed amendments to CRR, raising uncertainties as to how this provision applies. Participants agreed that 0% treatments should be available for intermediaries that act on a riskless basis with respect to the default of any non-client entity faced by such intermediaries in longer chains, but that CRR would best be clarified in this respect. Participants also discussed the lack of certainty surrounding the definition of a “sufficiently thorough legal review” under proposed amendments to Article 305(2)(c) of the CRR.

2.3. A second issue of legal uncertainty pertaining to the proposed new CRR provisions was located in Article 305(2)(a). Mr Donegan outlined that the article’s wording describing client segregation broadly mirrored that used to describe European-style individual segregation in Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (the “**European Market Infrastructure Regulation**” or “**EMIR**”). He noted that this wording resulted in legal uncertainties as to whether the provisions also apply to legally segregated; operationally commingled (“**LSOC**”) accounts at U.S., Singaporean and other clearing houses. Two solutions to this issue were proposed: (i) to align the article with European “equivalence” requirements, so as to allow the individual segregation

models of CCPs that are regulated or recognised under EMIR to be subject to the same capital requirements as are available for individual segregation in Europe; or (ii) to change the wording to reflect Basel III provisions, which are more generic in describing individual segregation models than CRR.<sup>1</sup> Participants agreed that under any teleological interpretation, the E.U. cannot have intended to deviate from Basel III standards on this important point and that either of these was a sensible interpretation of the provision as it stands.

2.4. Forum members agreed that the FMLC could consider taking both of these issues forward. Thomas Donegan offered to compose the necessary briefing note for the Committee.

**3. Discussion on tensions between the new E.U. intermediate holding company (“IHC”) rule and U.S. structural rules/limitations applicable to banking organisations. (Julia Smithers Excell)**

3.1. Julia Smithers Excell began by outlining the proposal, published in November 2016, by the European Commission to introduce an E.U. IHC requirement in Article 21b of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (“**CRD IV**”). The proposed new rules require non-E.U. global systemically important institutions (“**GSIs**”), or other groups with total E.U. *situs* assets in excess of €30 billion, with two or more banks or investment firms established in the E.U. to operate through an E.U. IHC.

3.2. Ms Smithers Excell highlighted that a significant conflict arises because U.S. legislation in effect requires banks to separate their corporate chain (broker-dealer activities) and bank chain (commercial and retail activities), which would have to be combined in the E.U. so as to comply with Article 21b.

3.3. Charles Gray was invited by Ms Smithers Excell to share his expertise on the matter. Forum members agreed that this issue gave rise to significant legal uncertainty and further work on it should be recommended to the Committee.

3.4. Forum members also drew attention to the work conducted by The Clearing House (“**TCH**”) and the Institute of International Finance (“**IIF**”) on this issue. Forum members suggested that the FMLC could build on work done by TCH and IIF but with a

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<sup>1</sup> <http://www.bis.org/bcbs/base13/b3summarytable.pdf>

focus on the legal uncertainties, and that the FMLC might look to contact TCH for a coordinated response.

**4. Unresolved issues related to the TLAC/MREL proposals.**

- 4.1. Bob Penn noted a technical issue with the definition of the minimum requirement for own funds and eligible liabilities (“MREL”) in relation to its relationship with Tier 2 capital requirements under the proposed amendments to the CRR. It was noted that proposed Article 63(n), dealing with the eligibility of Tier 2 instruments, rendered Tier 2 instruments eligible only where they ranked below any claim from eligible liabilities instruments. Where institutions had legacy outstanding Tier 2 securities which met the conditions for eligible liabilities instrument status under Article 72b, these would render all Tier 2 capital *pari passu* with the legacy Tier 2 securities ineligible for Tier 2 status. Forum members agreed to recommend further work on this issue to the Committee.

**5. Administration: a short presentation on the operation of FMLC Working Groups.<sup>2</sup> (Venessa Parekh)**

- 5.1. Venessa Parekh described the different characteristics of scoping fora and working groups: how working groups can be initiated and established; the objectives of working groups; the conduct of business of working groups; and how the Secretariat supports working groups.

**6. Any other business**

- 6.1. No other business was raised.

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<sup>2</sup> Please see Appendix II below.

# Operation of FMLC Working Groups

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Venessa Parekh, FMLC Acting Project Secretary

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Standing forums are convened quarterly to provide a space for exploration and discussion

# FMLC

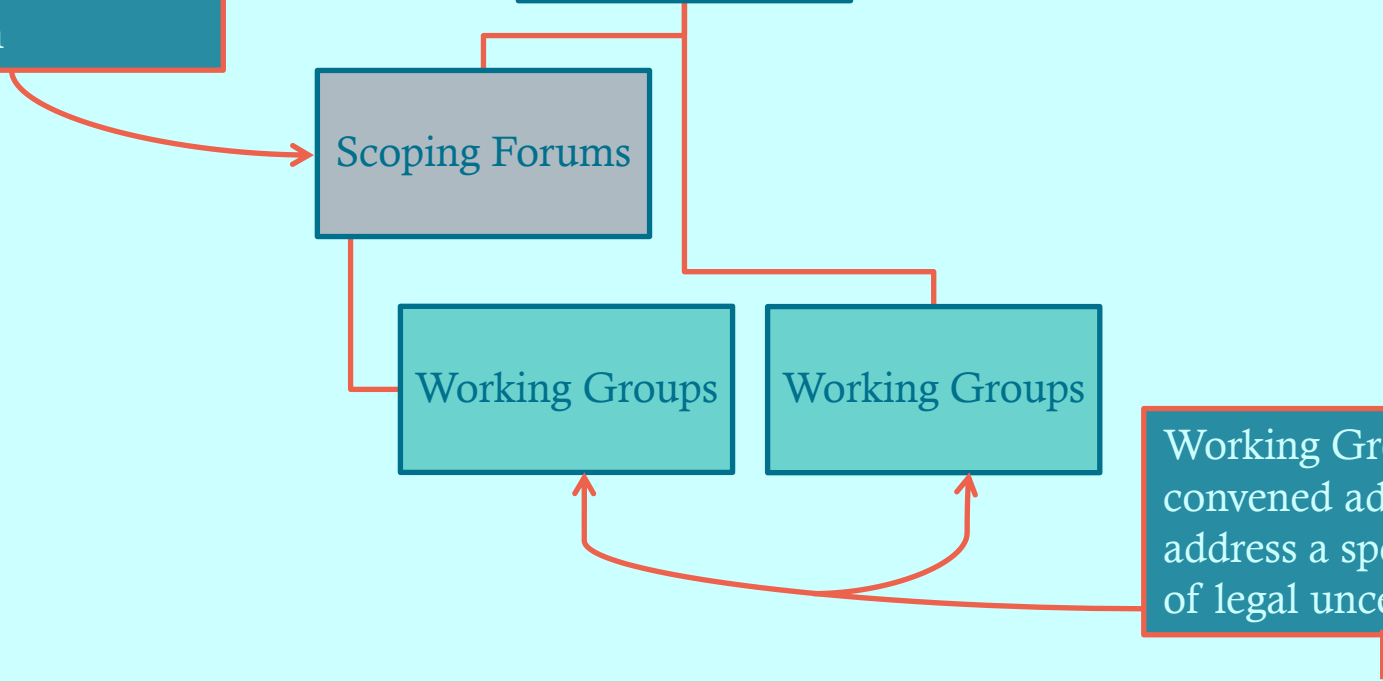
Scoping Forums

Working Groups

Working Groups

Working Groups are convened ad hoc to address a specific issue of legal uncertainty

N.B. Working Groups may be established on the basis of: 1) a recommendation from a Scoping Forum; 2) a stakeholder proposal; 3) a consultation request; or 4) Secretariat research.



# Working groups: objectives

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- The ultimate function of a Working Group established by the FMLC is to assist the Committee to address a specific issue of legal uncertainty by expressing an authoritative consensus.
- Pursuant to this aim and to the FMLC's remit, a Working Group will have the following objectives:
  1. to encourage discussion and the expression of a range of views;
  2. to build consensus that can be expressed in an FMLC publication; and
  3. to produce a draft publication to which, ideally, as many Working Group members have contributed as possible.

# How are working groups initiated?

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- Working Groups are established by the FMLC on the basis of a note specifying the relevant legal uncertainty (the “brief”).
- This brief defines the scope of work to be undertaken. It serves a threefold function:
  - to establish controls over the group’s output on behalf of FMLC Members;
  - to inform prospective contributors as to the scope of the project; and
  - to assist the Chair and Secretariat to allocate appropriate resources to the project, according to its expected size and complexity.
- In the case of work recommended by the members of a Scoping Forum or any other stakeholder(s), the brief should be prepared by the person or persons making the recommendation and put before the FMLC Committee for approval. (The FMLC Secretariat will normally offer formatting and other assistance in preparing the brief.)



# Working groups: conduct of business

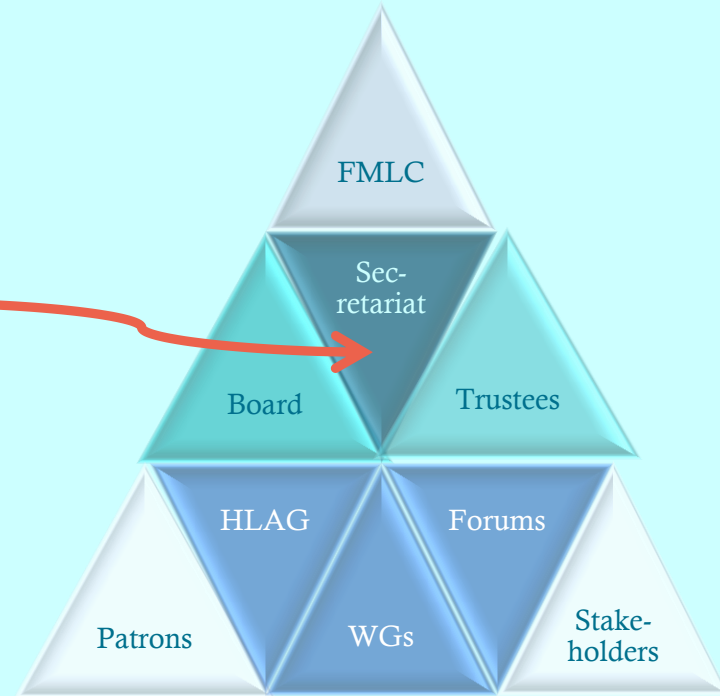
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- Working groups are convened under Terms of Reference, including conduct of business guidelines. These include the following:
  1. to encourage a diversity of perspectives, Working Group participation is limited to one member per organisation;
  2. to ensure accountability and transparency, alternates are, as a general rule, not permitted to attend meetings; and
  3. to foster individual engagement, Working Group meetings are to be attended in person, where possible. (Accordingly, the FMLC Secretariat does not provide dial-in details for working group meetings unless a member is based abroad.)
- Work within the Group follows a schedule (“Milestones”) established at the inaugural meeting and implemented by the FMLC Secretariat.

# Working groups: FMLC Secretariat

- The Secretariat supports the Chair and the Working Group during meetings, and manages Group-related communications outside meetings.
- The Secretariat helps draft and circulate meeting agenda and related documents in advance of Working Group meetings and takes minutes.
- Contributors are asked to send draft submissions to the Secretariat, whether directly or in copy.



# Conclusion / The End

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**Financial Markets Law Committee**

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