Financial Markets Law Committee ("FMLC")

Asset Management Scoping Forum

Date: Thursday 21 March 2019

Time: 2pm to 3.30pm

Location: Fried, Frank, Harris, Shriver & Jacobson (London) LLP, 41 Lothbury, London EC2R 7HF

In Attendance:

Gregg Beechey (Chair)	Fried, Frank, Harris, Shriver & Jacobson (London) LLP
Philip Bartram	Travers Smith LLP
Iain Cullen	Simmons & Simmons LLP
David Gasperow	Orbis Investment Advisory Limited
Henrietta De Salis	Willkie Fair & Gallagher (UK) LLP
Monica Gogna	Dechert LLP
Jon May	Marshall Wace LLP.
Emma Rachmaninov	Freshfields Bruckhaus Deringer LLP
Palvi Shah	J.P. Morgan Asset Management
Tom Taylor	British Private Equity & Venture Capital Association
Sam Wilson	Fried, Frank, Harris, Shriver & Jacobson (London) LLP
Virgilio Diniz	FMLC

Guest Speakers

Mete Feridun	PricewaterhouseCoopers UK
Andrew Weddell	PricewaterhouseCoopers UK

Regrets:

Owen Lysak	Clifford Chance LLP
Michelle Moran	K&L Gates LLP
Neil Robson	Katten Muchin Rosenman UK LLP

Minutes:

1. Introductions

1.1. Gregg Beechey opened the meeting.

2. Administration: Elsewhere at the FMLC (Virgilio Diniz)[1]

2.1. Virgilio Diniz described to the members the work FMLC has been doing in other Scoping Fora and gave examples of topics being discussed.

3. Legislative proposal (Proposal for a regulation on the prudential requirements of investment firms and amending Regulations (EU) No 575/2013, (EU) No 600/2014 and (EU) No 1093/2010) in the E.U. on investment firm review (Mete Feridun and Andrew Weddell)

3.1. Mr. Mete Feridun and Mr. Andrew Weddell introduced remarks in the review of the prudential framework for investment firms. Mr Feridun and Mr Weddell said that that the final compromise texts on the regulation and the directive were announced two days ago on 19 March 2019 following discussions between the European Council, Commission and Parliament.

3.2. Mr. Feridun and Mr. Weddell explained that the new regime would revise capital requirements, capital composition, group consolidation, liquidity requirements, reporting, disclosure, governance, remuneration and supervision of investment firms as set out in Directive 2013/36/E.U. 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 4**") and 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 and amending Regulation (EU) No 648/2012 ("**CRR**"), and in the Directive 2014/65/E.U. of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ("MiFID II") and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 ("**MiFIR**"). He said that the regime would introduce a more proportionate and fit-for purpose regime for investment firms. Mr Weddell added that the new framework presented a significant revision to the existing prudential framework for investment firms. He said that he regime was relevant for

[1] Please see Appendix I below.

firms undertaking MiFID activities including the Prudential sourcebook for Investment Firms ("**IFPRU**") and the Prudential sourcebook for Banks, Building Societies and Investment Firms ("**BIPRU**"), collective portfolio management investment firms as well as CRR investment firms supervised by the Prudential Regulation Authority ("**PRA**").

3.3. He explained the key components of the regime, which introduces tailored rules for a new class of firms alongside the three main categories of investment firms –systemic ones ("**Class 1**"), which provide "bank-like" services and whose consolidated assets exceed € 15 billion, being automatically subject to CRR and **CRD4**; non-systemic but still important ones ("**Class 2**"); and small non-interconnected firms ("**Class 3**").

3.4. Mr. Feridun explained that, in fact, the brand new category is called "**Class 1 minus**", whereby firms engaged in "bank-like" activities with consolidated assets (based on balance sheet) between € 5 and 15 billion could be requested to apply CRR/CRD4, at the discretion of their National Supervisory Authority ("**NSA**"), in particular if the firm's size or activities would involve risks to financial activity. In regards to Class 1 firms, amendments now explicitly include the assets of each branch of the third country group authorised in the E.U. in the combined total value of assets of all undertakings in the group. In regards to Class 2 firms, he explained that there is also a brand new regulation framework with new parameters and methodology for capital requirements ("**K-factors**") calculation, whereby the capital requirement will be determined as the highest of the 3 metrics, namely, the K-factors –risk to consumers ("**RtC**"), risk to market ("**RtM**") and risk to firm ("**RtF**"), permanent minimum capital requirement ("**PMC**") and fixed overhead requirements ("**FOR**"). For Class 3 firms there will be more proportionate prudential rules and they will be allowed to include trade receivables and fees/commissions receivable within 30 days as liquid assets, subject to a 50% haircut.

3.5. Mr. Feridun also explained that, besides capital requirements and liquidity, the review of the prudential framework for investment firms also introduces tailored rules for investment firms in other areas including reporting and disclosure, governance and remuneration, and consolidated supervision. He also mentioned what he considers as being controversial areas of the new regime, such as:

a) the consolidated supervision, whereby sufficient capital is needed at the top-company/entity level and capital requirements may apply on a consolidated supervision, depending on the interconnectedness amongst the entities;

b) the drop of the whole third country equivalence regime and the unclear definition of credit institution in relation to the CRD4 and CRR; and

c) liquidity requirements and remuneration policies.

3.6. Mr. Feridun and Mr. Weddell pointed out that the regime would need to be transposed by national competent authorities ("**NCAs**") within 18 months after publication in the Official Journal. He clarified that the publication was expected in October 2019, which meant the regime would come into force in April 2021, at the latest. He added that a transition period of five years would be in place for capital requirements, during which capital requirements would be limited to twice the firms' current capital requirements under CRR or twice their fixed overheads in the case of firms which were not subject to capital requirements under CRR. He added that the CRR market risk rules will continue to apply for five years or until the application of the Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements, and Regulation (EU) No 648/2012 ("**CRR2**"), whichever would be later.

3.7. Mr. Weddell said that in the U.K. it remained to be seen what impact Brexit would have on the new rules but given the Financial Conduct Authority ("**FCA**")'s significant contribution to the proposals, it would be expected that the U.K's implementation would align closely with the E.U. approach. He also added that the new rules on remuneration would be one of the key areas that the senior management at investment firms is expected to interested in. In conclusion, Mr. Feridun and Mr. Weddell said that it was certain that the package would introduce strategic, operational and regulatory challenges for investment firms in terms of complying with the key aspects of the regime ranging from adopting the K-factors approach to new regulatory reporting and disclosure requirements so they should start preparing for the new regime sooner rather than later.

4. Marketing funds from the U.K. into the E.U. post-Brexit

4.1. Mr. Beechey began by reporting the findings from an informal survey of local counsel across the EU that only firms which were registered or had an agent in the E.U. would be able to carry on marketing activities under MiFID II. Other U.K. firms might have to rely on alternative arrangements, such as reverse solicitation, to conduct such activities in the E.U.

Such firms are likely to have more limited permissions than those which are eligible under MiFID II. Another alternative method for U.K. firms wishing to provide marketing activities in the E.U. is by applying for an "equivalence" determination by the European authorities. Mr Beechey noted that the U.K. would continue to implement MiFID II until after any transitional period. The question, at that point, would be whether the regulatory frameworks in the U.K. and E.U. would be similar enough that an extended equivalence determination might be granted. This would provide U.K. firms with the ability to provide more services under MiFID II than reverse solicitation.

5. Application of Securitisation Regulation

5.1. Mr. Beechey led a discussion about the territorial application of Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012 ("**Securitisation Regulation**") or ("**SR**"), mainly the application of obligations to non-E.U. issuers and transparency requirements under article 7 to the originator, sponsor and securitisation special purpose entities ("**SSPE**"). In this regard, a member pointed out that these requirements would be applied complimentary to article 42, which in turn has amended Regulation (EU) No 648/2012 ("**EMIR**") in relation to clearing obligations.

5.2. It was agreed, however, that consideration of the Securitisation Regulation was best undertaken in other fora.

6. Any other business

6.1. No other business was raised.

Elsewhere at the FMLC …

Virgilio Diniz, Project Manager, FMLC Secretariat

Addressing legal uncertainty

FMLC

Since 2003, the FMLC has analysed and made recommendations to resolve legal uncertainties in 222 disparate topics.

Solvency II

GDPR

Market Abuse Regulation

Brexit

EMIR

Emissions Allowances

Benchmarks Reform

Bail-in

Capital Markets Union

Sovereign Debt Collective Action Clauses

Rome I

Bank Reform (Ring Fencing)

International Coordination of Law and Regulation

Regulation of Credit Rating Agencies

MiFID II

Bank Recovery and Resolution

Financial Market Infrastructures

Virtual Currencies

Remit and Scope

"The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed."

FMLC Founding Documents, September 2002

The FMLC's remit covers the entirety of the wholesale financial markets. In order to identify issues of legal uncertainty, the FMLC Secretariat runs nine "horizon scanning" Forums, each focused on a specific area of the financial services.

We thought you might be interested in the recent priorities of the other Forums.

Banking

- Originally established to review the European banking reform package which proposed fundamental changes to E.U. legislation on bank resolution and bank capital.
- In recent months, the Forum has considered:
  - The European legislative proposal for a Directive on credit services, credit purchasers and the recovery of collateral;
  - The preparations by the loan market ahead of the discontinuation of LIBOR; and
  - Draft secondary legislation incorporating relevant E.U. law into U.K. statute books.

Brexit

- Established to provide a space for discussion of current and future complexities affecting the financial markets as a result of the U.K.'s secession from the E.U. This group is also tasked with providing advice and guidance to the FMLC on the scope and nature of work which relates to the referendum and consequential withdrawal.
- This Forum has considered:
  - The options for the U.K.'s future relationship with the E.U.;
  - The European Union (Withdrawal) Bill (now enacted); and
  - HM Treasury's preparations for withdrawal by way of the publication of secondary legislation "onshoring" E.U. law

FinTech

F M L C

- Established to encourage discussion of current and future issues of legal uncertainty arising in the context of technological innovations in financial markets.
- Recently, this Forum has discussed:
  - The evolution of U.S. regulatory position on cryptocurrencies;
  - ISDA's recent report on smart contracts;
  - New regulations in Gibraltar on the use of DLT and tokens; and
  - The FCA's consultation on cryptoassets and the U.K.'s regulatory perimeter.

Infrastructure

- Established to provide a space for discussion amongst market infrastructure bodies and a channel of communication between the market infrastructure sector and the public authorities.
- Recently, this Forum has discussed:
  - ESMA Q&As on the Benchmarks Regulation;
  - ESMA Public Statement on managing the risks of a no-deal Brexit in the area of central clearing;
  - The Draft Payments and electronic money(Amendment) (EU Exit) Regulations; and
  - The Draft Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018.

Insurance

- Established to identify current and future issues of legal uncertainty that are of concern to the insurance industry.
- Recently widened to bring into scope the pensions industry.
- This Forum's priorities over the past year include:
  - The development of cyber insurance;
  - The impact of Brexit on existing insurance contracts; and
  - The PRA's consultation on credit risk mitigation

Primary Markets

- The FMLC resolved in January 2019 to establish a new Forum for horizon scanning purposes in respect of the primary markets
- The Forum will consider topics including the aspects of MiFID II and MAR which impact on primary markets, the Prospectus Regulation and PRIIPS, non-MiFID primary markets conduct, infrastructure financing and securitisation issues.

Quarterly Discussion Forum

- The Quarterly Discussion Forum call is a bilateral teleconference between the FMLC and the Financial Markets Lawyers Group (the "FMLG", associated with the New York Federal Reserve).
- In recent months, topics discussed on these calls have included Brexit, the phasing out of LIBOR and the development of alternative reference rates, and the Benchmarks Regulation.
- This is a "closed" Forum in the sense that it does not have a standing membership and is usually attended by Members of the FMLC. The Secretariat would be grateful, however, to hear from persons who might volunteer to attend as a guest speaker.

Sovereign Debt

- Established to provide a space for ongoing discussion regarding legal uncertainty issues affecting sovereign debt under English, European, international and, possibly, foreign law.
- Last year, this Forum:
  - Welcomed guest speakers, Lee Buchheit and Mitu Gulati, to discuss the Venezuelan debt crisis;
  - Considered the "odious debt" defence; and
  - Discussed a proposal to make "secret" loans unenforceable.

Conclusion

- If you wish to enquire about your firm's participation in any of the Scoping Forums, please do get in touch.

- The Secretariat is always pleased to receive recommendations for topics for discussion or guest speakers.

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