



Financial Markets Law Committee (“FMLC”)

Infrastructure Scoping Forum

Date: 8 August 2019

Time: 2.00pm to 3.30pm

Location: Allen & Overy LLP, One Bishops Square, London, E1 6AD

In Attendance:

Emma Dwyer (Chair)	Allen & Overy LLP
Thomas Donegan	Shearman & Sterling LLP
Jonathan Gilmour	Travers Smith
Nathaniel Lalone	Katten Muchin Rosenman UK LLP
Natalie Lewis	Travers Smith
Hannah Meakin	Norton Rose Fulbright LLP
Michael Sholem	Cadwalader, Wickersham & Taft LLP
Julia Smithers Excell	White & Case LLP
Keti Tano	The London Metal Exchange
Virgilio Diniz	FMLC
Katja Trela-Larsen	FMLC

Regrets:

Antony Beaves	Bank of England
Damian Carolan	Allen & Overy LLP
John Ewan	
Nick Carew-Hunt	
Will Ingram	CME Group
Iona Levine	Minerva Chambers
Nathan Renyard	Cboe Global Markets, Inc
Alex Rutter	Tradeweb

Registered Charity Number: 1164902.

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Minutes

1. Introductions

1.1. The Chair opened the meeting and asked attendees to introduce themselves.

2. The FMLC's Public Education Function: Speeches (Virgilio Diniz)

2.1. Mr. Diniz delivered a short presentation¹ on the FMLC's Public Education Function, a key aspect of the FMLC's mission as a charity.

3. "Onshoring" the EMIR Refit – The over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc. and Transitional Provisions) (E.U. Exit) regulations 2019 ("S.I. 2019/335") (Nathaniel Lalone)

3.1. Mr. Lalone pointed out that one of the priorities of the HM Treasury is to improve regulation of the financial sector to protect customers and the economy, and to make it easier for people to access and use financial services.

3.2. He explained that the S.I. 2019/335 was made to address failures of retained EU law to operate effectively and other deficiencies arising from the withdrawal of the United Kingdom from the European Union. He added that it was relatively brief, and amends the Central Counterparties (Amendment, etc., and Transitional Provision) (E.U. Exit) Regulations 2018 ("**S.I. 2018/1184**") which was related to the modifications introduced by Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories ("**EMIR Refit**"). Generally speaking, the large majority of the S.I. 2019/335 is updating the S.I. 2018/1184.

3.3. He added that, as from the legal uncertainty point of view, there were only very few observations which should be considered as of material legal effect. Mr. Lalone suggested that the statutory instrument should be understood in light of the associated. He stated that the supervision of the clearing obligation for certain derivative contracts would from exit day be overseen by the Bank of England, which would also be responsible for authorising and supervising the Central Counterparties ("**CCPs**") through which the clearing obligation would be met. He also clarified

¹ Please see Appendix 1

that the cases of suspension of the clearing obligation, their extensions and their effects on the trading obligations would also be under the Bank of England responsibility and in certain specific cases, the Financial Conduct Authority (“**FCA**”).

3.4. Following that, he stated that certain references to pensions schemes and cross-references to the reporting obligation of third countries seemed to have been removed from the S.I. 2019/335, although he highlighted that was not necessarily a fundamental issue of legal uncertainty.

3.5. One member stressed that the onshoring package contains a great many confusing cross-references.

4. **WGMR – the use of money market funds as eligible collateral under the uncleared margin rules** (Emma Dwyer)

4.1. Ms. Dwyer made introductory remarks on the subject of the use of money market funds as collateral under the uncleared margin rules. She highlighted that the market has been struggling to understand the conditions to be met arising out of the Commodity Future Trading Commission rules (“**CFTC rules**”)² and the Money Market Funds (Amendment) (EU Exit) Regulations 2019 or (“**S.I. 2019/394**” / “**U.K. rules**”). She also commented that the interpretation of the [guidance sought](#) by the International Swaps and Derivatives Association (“**ISDA**”) is far from being certain.

4.2. The background of the industry’s use of cash and money market funds (“**MMFs**”) as collateral in the derivatives market indicates a substantial huge proportion of cash as being used as collateral in such market. In fact, apart from cash and other highly liquid funds such as government bonds, the conditions of eligibility set forth at the [European Commission Delegated Regulation \(EU\) 2016/2251](#) (“**EMIR Margin RTS**”) of other less liquid MMFs, such as units or shares in UCITS, as collateral, are not clear. The conditions set forth in Article 5 of EMIR Margin RTS are not straightforward. This means that it is not clear, for example, whether U.S. bonds might be eligible for collateral in the E.U. derivatives market, as the Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (“**UCITS Directive**”) requires that such shares or units must be located within the E.U. Moreover, it is not clear also how to apply value, haircuts and other criteria, such as those described in sections 8.1 and 8.2 of the EMIR Margin RTS.

² Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (“**CFTC rule**”): 81 Fed. Reg. 636 (January 6, 2016).

4.3. Ms. Dwyer also pointed that there is a lack of clarity in the liquidity requirements applicable to a purely collective portfolio management investment firm which may impact cross-border investments such as U.S. funds in to the E.U. and vice-versa. The absence of any ability to rely on equivalence may exacerbate the lack of clarity.

5. Plenary discussion on recent and anticipated legislation and developments—potential areas of focus for future meetings (Emma Dwyer)

5.1. Members entered into a discussion about the different phases of the Brexit process in relation to collateral and pointed that regulators would have substantial power. Questions arise as what to do when U.K. market agents rely on an ESMA Q&A, or disagree with an ESMA Q&A. Also, members touched the Capital Requirement Regulation (“**CRR2**”) section which deals with bank exposures, transactions, margins and the absence of recognition of indirect clearing.

6. Any other business³

6.1. No other business was discussed.

³

The next meeting of the Infrastructure Scoping Forum will be held on Thursday 7 November between 2.00pm and 3.30pm.

The FMLC's Public Education Function: Speeches



Virgilio Diniz, Project Manager

Registered Charity Number: 1164902.

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The FMLC's charitable remit



According to the charitable remit, the FMLC has a tripartite mission:

- to *identify* relevant issues (the **radar** function);
- to *consider* such issues (the **research** function); and
- to *address* such issues (the **public education** function).

Reduced legal uncertainty and risk is in the public good; the *radar* and *research* functions are somewhat self-explanatory in this regard. The *public education* function is a key aspect of the FMLC's status as a charity, and is addressed in the following ways:

- All FMLC papers, presentations/speeches and correspondence are freely available via the FMLC website.
- The FMLC seeks to raise the profile of its research with those who are best positioned to implement solutions. This is achieved primarily through correspondence: the FMLC maintains active correspondence with regulatory and legislative groups around the world, particularly HM Treasury and the European Commission.
- Most FMLC events (with the exception of Patrons' events) are free to attend by members of the public.
- The FMLC also acts as a bridge to the judiciary, a task it carries out primarily by organising seminars to brief senior members of the judiciary on aspects of wholesale financial markets practice.

The Public Education Function

- Along with publications and events, the FMLC Secretariat furthers the Committee's education function by giving speeches about legal developments and issues of legal uncertainty in the financial markets.
- These speaking engagements may be at high-profile events or at a smaller gathering of an interested audience at a stakeholder firm.
- Members of the Secretariat have presented to audiences, within law firms for example, which are interested in learning about current issues facing the financial markets.
- The FMLC used to be CPD-qualified and such talks presented excellent training opportunities.
- Example of topics on which the Secretariat has presented are set out in slides below.

Brexit, FinTech and FinTech Regulation After Brexit

Transitional Period: "Fourth" Country

- Another uncertainty arising in the context of a transition period will be a result of the U.K.'s status during the period as a Member State.
- While the U.K. will continue to be considered a Member State for the purposes of intra-E.U. business, such as for the purposes of not legally continue to be party to the E.U.'s treaties with other states.
- For example, U.K. CCPs may not automatically be substituted compliance concessions awarded by the CFTC.
- It will be necessary to start from scratch with the U.K. authorities to negotiate bilateral memoranda of understanding with each Third Country jurisdiction in order to ensure that the U.K. is able to continue to provide effective access to date.

FinTech Today

- At the end of 2018, Blockchain and cryptocurrency usage was over 2000 types of digital currencies.
- In March 2019, the European Central Bank launched a trial of cross-border digital currencies.
- On 28 June 2019, Facebook launched "stable global cryptocurrencies".
- Blockchain venture capital funding reached \$1.1 billion in 2018.

Post-Brexit U.K. Fintech Regulation

- **HMT Consultation on Transposition of 5th Money Laundering Directive**
 - Expands regulatory perimeter to include virtual currencies and custodian wallet providers
- **FCA Cryptoassets Taskforce Report**
 - Sets out measures that the U.K. authorities intend to take regarding cryptoassets, including regulating financial instruments that reference cryptoassets and consulting on extending the regulatory perimeter for ICOs
- **FCA's Feedback Statement (FS17/4) on its Discussion Paper (DP17/3) on DLT**
 - Suggests current rules are flexible enough to accommodate use of DLT and that the FCA will continue to monitor DLT-related market developments
- **FCA granting e-money licences**
 - The FCA granted its first e-money licence to Coinbase in March 2018
- **FCA Guidance (FG16/5) for firms outsourcing to the "cloud"**
 - Lists areas of guidance that firms should consider when outsourcing to the cloud and other third-party IT services, including legal and regulatory concerns and effective access to date.

IBOR Transition (at the P.R.I.M.E Finance Conference 2019)

SONIA (GBP)

The definition of SONIA has two elements:

- (i) Statement of underlying interest

SONIA is a measure of the rate at which interbank wholesale funds in circumstances where credit is provided.

- (ii) Statement of methodology

On each London business day, SONIA is measured to four decimal places, of interest rates paid on eligible transactions.

Eligible transactions are:

- reported to the Bank's Sterling Money Market daily data
- the effective version of the 'Reporting Instructions for Financial Institutions' for unsecured and of one business day maturity;
- executed between 00:00 hours and 18:00 hours UK time and
- greater than or equal to £25 million in value.

Euro Rates

EURIBOR is the rate at which Euro interbank term deposits are offered by one prime bank to another prime bank within the EMU zone, and is calculated at 11:00 a.m. (CET) for spot value (T+2).

EONIA is a rate which represents the rates at which banks of sound financial standing in the European Union and European Free Trade Area (EFTA) lend funds in the overnight interbank money markets in Euro.

ESTER is a rate which reflects the wholesale euro unsecured overnight borrowing costs of euro area banks. The rate is published for each TARGET2 business day based on transactions conducted and settled on the previous day (reporting date T) with a maturity date of T+1 and which are deemed to be executed at arm's length.

Brexit and finance: the legal framework

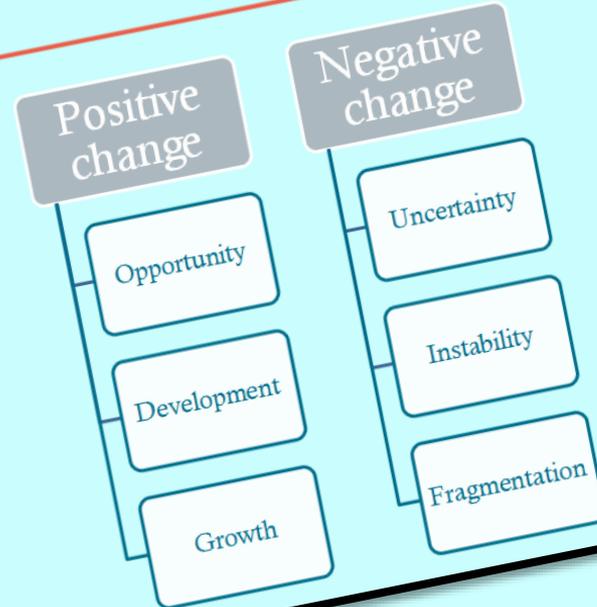
Covering note on the Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018

5 Following this model will mean that EU 'Level 1' legislation (which was developed by the European Commission and negotiated through the Council and European Parliament) and 'Level 2' legislation (apart from BTS and certain other technical elements of Level 2), will become the responsibility of the UK Parliament. This body of EU legislation includes provisions which set the policy direction for financial services, so it is appropriate that responsibility for deciding how deficiencies are fixed in this legislation should rest with Parliament. HM Treasury will propose amendments to this legislation, using the powers under the EUWB, ensuring that Parliament is able to scrutinise all of the changes. It is expected that the majority of the statutory instruments needed to correct deficiencies in this legislation will be laid under the affirmative procedure.

6 For certain EU 'Level 2' technical rules, known as Binding Technical Standards (BTS), HM Treasury proposes to transfer ongoing responsibility from the European Supervisory Authorities to the UK financial regulators – the Bank of England, the PRA, the FCA and the Payment Systems Regulator (PSR). BTS, running to several thousand pages, do not set overall policy direction but fill out the technical detail of how the requirements set at Level 1 are to be met. Having played an important role in the EU to develop these standards, through their membership of the Boards and working groups of the European Supervisory Authorities, UK regulators have the necessary expertise and resource to maintain them after the UK's exit from the EU. This allocation of responsibility would be consistent with the general rule-making responsibilities already delegated to the FCA and PRA by Parliament under FSMA.

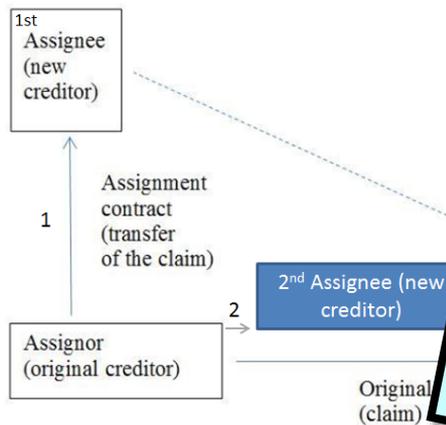
7 As HM Treasury proposes to transfer ongoing responsibility for BTS to the UK regulators, it also makes sense that the regulators perform the task of making corrections to deficiencies in existing BTS so that these rules operate effectively in the UK at exit. HM Treasury therefore proposes to delegate to UK financial regulators the power to correct deficiencies in BTS arising from EU withdrawal.

Two faces of a Brexit future:



Conflicts of laws on securities and claims: collateralisation

Collateralisation and the assignment of claims



Collateralisation and the assignment of claims

- The Commission proposal insures that retail deposits, which are made against banks by natural person depositors, are governed by the law of the underlying claimant's habitual residence.
- This is the correct rule: high by a natural person, who is habitual residence.
- Situations in which individuals include the taking of security relationship, the assigning of bank account from one spouse to a company on the matters are excluded from the lead to competing entitlements a residence, it may be that only the generate a legally certain result.

Collateralisation and the assignment of claims

- Further, with regard to bank accounts in general, it is often argued that banks should be able to take a charge over their own indebtedness *vis à vis* their clients under the law of the assigned claim and irrespective of any rule to the contrary in the law of the latter's habitual residence.
- The question arose for consideration in the U.K. courts in two cases: *In re Charge Card Services Ltd* [1987] Ch 150, where it was held to be "conceptually impossible" that banks should take a charge in these circumstances, and *Re Bank of Credit and Commerce International SA (No 8)* [1998] AC 214, where the House of Lords settled the question and upheld the charge. In between these case decisions, legislation was enacted in several jurisdictions with common law influence (including the Cayman Islands, Bermuda, Singapore and Hong Kong) providing for the validity and enforceability of charges of this kind, which were common at the time and continue to be prevalent as a means of taking security today.

Summary and Conclusion

- The Secretariat is happy to visit your organisation and introduce legal uncertainties in a relevant area of the financial markets.
- This helps us get reach a wider audience of stakeholders, learn about the questions occupying their time and fulfil our public education.
- If you are interested, get in touch with Debbie Hayes at: secretarial@fmlc.org or with Venessa Parekh at: research@fmlc.org

