REGULATORY INTELLIGENCE

REGULATORY INSIGHTS – 2019 EDITION

BNP PARIBAS

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for a changing
world

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WELCOME

Welcome to Regulatory Intelligence, BNP Paribas Securities Services annual summary of regulatory developments.

We believe that changing regulations are a critical business issue for our clients and are shaping their priorities today. The pace of regulatory change calls for agility. Business models will need to be adapted and our insights help you address these issues.

This is the second edition which combines insights on European, Asia-Pacific and the United States regulations. Created by our Public Affairs team in Europe and our local specialists in Asia-Pacific and the United States, each concise memo covers a specific regulation, including its scope, implications for the industry and the key dates in the regulatory process. As a Bank that is actively engaged with regulators and keenly follows developments, we also include our point of view on each regulation.

We hope that you find the information useful, and look forward to receiving your feedback.

BNP Paribas Securities Services

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REGULATIONS IN EUROPE

ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE (AIFMD)

The Alternative Investment Fund Managers Directive (AIFMD) has introduced a framework to regulate and supervise Alternative Investment Fund Managers (AIFMs) and the distribution of Alternative Investment Funds (AIFs) within the EU.

Key objectives of the directive are to reinforce investor protection; limit systemic risk; ensure proper risk management by asset managers; provide common rules for authorisation, organisation and supervision of asset managers; and create a single market for these funds in the EU.

ABOUT AIFMD

The introduction of the AIFMD passport was expected to be conducted in 3 phases:

- **Period 1:** Since 22 July 2013, the passport has been available to EU AIFMs who manage or market EU AIFs to EU professional investors
- **Period 2:** The AIFMD passport was to be made available for AIFMs or AIFs located in selected third countries, depending on ESMA positive advice and on European Commission, Parliament and Council approval. Since 19 July 2016, ESMA has published positive advices to the European Commission (EC) on extending the passport under the AIFMD to AIFs and AIFMs domiciled in the following third countries: Jersey, Guernsey, Canada, Japan and Switzerland. The US, Australia, Hong Kong and Singapore also received qualified assessments

The adoption by the European Commission of the extension of the passport to third countries is currently delayed.

- **Period 3:** Potential end of National Private Placement Regimes (NPPRs)

The potential end of NPPRs was initially planned in 2018. Given that the end of national regimes depends on the extension of the passport to third countries, the end of NPPRs has also been delayed.

SCOPE

The AIFMD applies to all managers of non-UCITS investment funds that manage or market those funds in Europe, whether the AIFM and/or the AIF are located in Europe or not.

Even when the AIFM and/or AIF are not located in the EU and do not benefit from the passport, they must comply with competent authorities in the countries where the AIF is marketed under the NPPR.

INDUSTRY IMPLICATIONS

For asset managers that benefit from the passport, AIFMD requirements have translated into increased costs due to new rules and constraints in terms of organisation, risk management and remuneration. More specifically AIFMD requires:

- Three separate functions: the portfolio function, the risk management function and the valuation function
- Specific rules in terms of liquidity management, risk management and reporting to the competent authority
- The appointment of a single depositary for each AIF

Since July 2013, EU managers of EU AIFs can benefit from the EU marketing passport in exchange for compliance with all AIFMD provisions. Non-EU AIFMs and non-EU AIFs are restricted to marketing in the various countries where NPPRs are in place. When the EC extends the AIFMD passport to some non-EU countries, ESMA will be required to issue advice to the EC on the termination of NPPRs.

AIFMD has also translated into stricter rules for depositaries with regards custody. Among those rules, asset segregation and the role of investors' CSDs are subject to questioning and are still being interpreted in various ways depending on member states and market players. Following the publication of an opinion by ESMA on these topics in July 2017, amendments regarding AIFMD delegated acts on safekeeping duties of depositaries were adopted. At the depositary's delegates' level, the use of omnibus accounts including assets of AIFs, UCITS and other clients will be allowed. In counterparty, due diligence and verifications by the depositary all along the custody chain were strengthened and the depositary must keep a record for each AIF in its book for the assets whose custody has been delegated.

BNP Paribas Securities Services' view

- The new requirement for the depositary to hold a record of assets per fund in its books will, from 1 April 2020, introduce barriers to the appointment of prime-brokers by AIFs and the use of global custodians by depositaries.
- The possible consultation on the AIFMD review in 2019 should complete the clarification of remaining issues in the level 1 text (directive) provisions on safekeeping duties of depositaries. In particular, it is expected to clarify that investor CSDs are to be considered as delegates.
- The entry into force of the third-country passporting regimes and the abolition of NPPRs is currently delayed. However, when/if the passport is extended, due to the associated demanding and costly requirements that asset managers must comply with, middle and back-office outsourcing may be an attractive alternative to manage the associated costs. AIFs marketed under the passport also need to appoint a depositary. Given the depositary's liabilities, AIFs and AIFMs should look for a robust and reputable depositary.

KEY DATES

22 JULY 2014
All AIFMs must comply with relevant AIFMD provisions (effective authorisation by national competent authorities)

8 OCTOBER 2014
ESMA's guidelines on reporting obligations under AIFMD apply

30 OCTOBER 2018
Amendments of AIFMD delegated acts on safekeeping duties of depositories

2019
Possible EC consultation on the review of AIFMD

1 APRIL 2020
Entry into application of the new safekeeping duties of depositaries

CAPITAL MARKETS UNION (CMU)

The Capital Markets Union comprises several initiatives which collectively aim to create deeper and better integrated capital markets within the European Union (EU).

ABOUT CMU

Announced in November 2014, the CMU is an ambitious and long-standing initiative of the European Commission comprising several projects.

The CMU covers over 30 actions and related measures around key objectives such as:

- Capital raising on public markets and safe securitisation
- Long-term investments in infrastructure projects, technology and sustainable investments
- Retail and institutional investments
- Cross-border investment (between EU countries and also investing from outside the EU)

As of May 2019, 11 out of 13 proposals made under the CMU initiative have been agreed.

SCOPE

The CMU covers:

- **Better access to financing**
- **Diversifying sources of funding**
- Enabling **market efficiency and resilience**

A European Commission (EC) green paper issued in February 2015 identified the key principles to underpin the CMU and also the “quick wins” and longer-term topics. This division was maintained in its Action Plan published on 30 September 2015.

In parallel to the green paper, the EC conducted a call for evidence on the impacts of the past 6 years of financial reform. Following the **mid-term review of the CMU**, the EU institutions published a communication on the way forward, including consistent supervision to be achieved by strengthening the powers of the European Supervisory Authorities (revision in progress).

The EC also set up various working groups on: (i) technical aspects of corporate governance processes for corporate actions and (ii) barriers to free movement of capital on Withholding Tax and, (iii) shareholder identification.

The CMU initiative also includes Action Plans on Fintech and Sustainable Finance, published in March 2018.

The adopted proposals each cover a specific objective and scope of action:

- Collective Investment Funds: removing reducing barriers to cross-border investment funds and diverging national rules
- European Supervisory Authorities (ESAs) review: making the European system of financial supervision more effective and efficient
- Investment firms review: ensuring more proportionate rules and better supervision for all investment firms
- Covered bonds: developing a harmonised EU framework to fund the economy across the EU
- Small and medium-sized enterprises (SMEs) growth markets: supporting SMEs with cheaper and simpler access to public markets and dedicated trading venues
- Disclosure requirements on sustainable investments as part of the Action Plan on Sustainable Finance
- European market infrastructure regulation (EMIR) 2.2: ensuring a more robust and effective supervision of central counterparties (CCPs) offering services to the EU
- EMIR REFIT: providing simpler and more proportionate rules for over-the-counter derivatives

INDUSTRY IMPLICATIONS

- For institutional and retail investors: a greater choice of investments, accessible at lower costs, more effective investor protection
- For SMEs: better access to financing and fewer restrictions on financing
- For banks and insurers: more favourable conditions to connect financing (particularly long-term financing) to the real economy by means of a legislative proposal for simple, transparent and standardised securitisation, and the re-calibration of both the Capital Requirements Regulation (CRR) and Solvency II for financing infrastructure and large scale industry projects
- For financial institutions, investment firms and financial intermediaries: more competitive, better regulated and integrated EU capital markets with greater scale and depth
- For banks, in their role as intermediaries: better-functioning markets with fewer barriers to cross-border investments and an increase in the levels and values of transactions, both domestically and across the EU

BNP Paribas Securities Services’ view

- We welcome this flagship initiative and share the concerns on insufficient growth and difficult and insufficiently diversified access to finance. A real CMU should result in stronger integration of financial markets in the EU and should facilitate access for all investors to wider sources of financing.
- Concerning financial markets infrastructures, important changes are currently being implemented and we favour an approach where we first reap the benefits of T2S, CSDR and EMIR before making further changes.
- In the field of post-trade generally, a number of legislative texts are not yet in force. We take the view that legislation should be in application before entering into new legislative projects.

KEY DATES

SEPTEMBER 2015
Adoption of the action plan on the CMU

JUNE 2017
Mid-term review conclusions

Updated action plan

AUGUST 2017
Publication of the EPTF report

NOVEMBER – DECEMBER 2017
Publication of consultations and positions on sustainable investments, corporate bonds markets, withholding tax guidelines, SME listing and risk-sensitive rules for investment firms

Analysis of best practice for relief at source from withholding tax procedures

MARCH 2018
Publication of the Action Plans on Fintech and Sustainable Finance

JAN 2019
Entry into application of the new harmonised rules on securitisation

2019
Expected fully functioning CMU

CENTRAL COUNTERPARTY RECOVERY AND RESOLUTION REGULATION (CCP)

The establishment of a recovery and resolution regime for financial markets infrastructures is one of the last remaining elements of the post-crisis reform agenda for financial services in the European Union (EU). CCPs emerge from the market infrastructure reforms as the new 'too big to fail' institutions, after the implementation of clearing obligations for over the counter (OTC) derivatives through EMIR in 2012, and the implementation of trading obligations for shares and derivatives through MiFID II/MiFIR.

ABOUT CCP

Following the publication of several editions of guidelines at an international level (by the Financial Stability Board (FSB) on CCP resolution, and by the Committee on Payments and Market Infrastructures (CPMI-IOSCO) on CCP resilience and recovery), the European Commission released its own proposal for an EU regulation in November 2016. Authorities in Europe deem it necessary to have the adequate powers to step in when a CCP fails, and to be able to deal with it in an orderly manner.

Although no final text has been issued at EU level, discussions are still ongoing at international level. In spring 2018, CPMI-IOSCO published guidance on supervisory stress testing of CCPs and a report on the follow-up Level 3 assessment of CCPs' recovery planning, coverage of financial resources and liquidity stress testing. Further guidance is expected at the international level, in particular from the FSB which launched a consultation regarding financial resources for CCP resolution in November 2018.

SCOPE

- The EU regulation would be applicable to **all EU CCPs**

The proposal requires CCPs to draw up recovery plans which would include measures to overcome any form of financial distress exceeding the CCPs' pre-funded resources. This should include scenarios based on a clearing default by members of the CCP, and other non-default scenarios, such as fraud or cyberattacks. Recovery plans are to be reviewed by the CCP's supervisory authority.

CCP supervisors are granted specific powers to intervene in the operations of CCPs where their viability is at risk – even before they reach the point of activating the recovery or suffer an actual failure. Supervisors could also require the CCP to undertake specific actions ("Early Intervention") or to change its business strategy, legal or operational structure, or its recovery plan.

A CCP will be placed in resolution when it is failing, when no private sector alternative can avert the failure, and when its failure would jeopardise the public interest and financial stability. EU Member States should designate a Resolution Authority, which will be responsible for preparing resolution plans outlining how their respective CCPs would be restructured and their critical functions maintained in this event.

INDUSTRY IMPLICATIONS

Central clearing is based on two fundamental principles: risk sharing and, if need be, acceptance of loss-sharing for the benefit of preserving a greater value and maintaining the cleared portfolio as intact as possible. Thus one major issue is to define who would contribute to loss allocation.

CCPs will certainly have to comply with further transparency requirements and increase resources available for the default management process.

Banks mainly face a higher cost of risk. They may also need to review risk policies regarding CCPs and clearing clients due to new rules on recovery and resolution tools, and on loss allocation.

Clearing brokers may need to make new disclosures to clients and potentially amend clearing contracts so that they reflect liabilities and rights that may result from CCP recovery and resolution.

BNP Paribas Securities Services' view

- We welcome this EU initiative to establish a resolution and recovery regime for CCPs. Its primary aim should be preserving market stability, ensuring service continuity, and avoiding contagion effects.
- This initiative should also respect the existing rules under EMIR on CCP governance, risk management, and default management process. Where necessary, it should advance those rules so as to guarantee more robust CCPs with greater capacity to sustain and manage internal crisis situations.
- Furthermore, the CCP recovery and resolution regime should strike a balance between the risk-related and commercial concerns of the CCPs, and those of the clearing members and their clients.
- There should also be distinct rules for loss-allocation in default-induced crises and in non-default loss scenarios. In the latter case, the responsibility should be primarily upon the CCP and losses should not be shared among clearing participants. The default waterfall should be fully protected from non-default losses. Initial Margins should be bankruptcy remote.

KEY DATES

AUGUST 2016
CPMI-IOSCO and FSB consultations on CCP resilience, recovery and resolution. Publication of joint reports.

NOVEMBER 2016
EU Commission proposal for a framework for the recovery and resolution of CCPs

DECEMBER 2017
Draft Presidency Report by the Estonian Council Presidency published

JANUARY 2018
European Parliament adopts its position on the Commission proposal, Council position still pending. New reports to be expected from FSB and CPMI – IOSCO

NOVEMBER 2018
FSB consultation on financial resources for CCP resolution and the treatment of CCP equity in resolution launched

2020
Expected application date of the European Commission text proposal

CENTRAL SECURITIES DEPOSITORIES REGULATION (CSDR)

The Central Securities Depositories Regulation applies to European Central Securities Depositaries (CSDs), their participants, and to securities settlement systems in the European Union (EU).

ABOUT CSDR

Its objective is to introduce a European regime governing various issues related to Central Securities Depositories, including:

- Rules on the authorisation, supervision and passporting of CSDs as well as minimum organisational requirements for them
- Conditions under which they may provide banking services
- Minimal harmonised rules governing securities settlement and settlement discipline
- Internalised settlement

The regulation was published in the Official Journal in August 2014 and is gradually entering into force. **The authorisation of CSDs in Q1-Q2 2018** was a major step in its effective implementation. In March 2017, the EU Commission published Regulatory Standards on: (i) authorisation and supervision of CSDs; (ii) prudential requirements for CSDs; (iii) reporting of internalised settlement; and (iv) cash penalties.

In May 2018, the European Commission published settlement discipline rules. These rules will enter into force on 14 September 2020.

SCOPE

The regulation contains rules on dematerialisation of securities and on securities settlement systems. It applies to:

- CSDs, i.e. entities that operate a Securities Settlement System and accept issuance from the issuer and/or hold securities at a centralised level
- Issuers that issue securities in EU CSDs
- Participants to CSDs
- Banks that offer banking services to CSDs

INDUSTRY IMPLICATIONS

The CSDR requirements provide detailed legislative provisions on:

- **Settlement:** harmonisation of settlement cycles to T+2; dematerialisation of issuances by 2020 and entry into force of level 2 legislation; harmonisation of settlement discipline rules
- **Central Securities Depositories:** provisions on internal organisation including user committees, board members, minimum obligations such as reconciliation, acceptance of issuances from issuers, fair and open access to CSDs
- **Banking services:** conditions under which CSDs may provide banking services or use banks
- **Intermediaries:** disclosure of settlement internalisation and use of segregated accounts under certain conditions

CSDR could lead to:

- **Simplification of issuance abroad and facilitated cross-border settlement (key feature of T2S):** issuers being able to issue securities in any EU CSD
- Mandatory buy-ins and higher failed settlement penalties, which may impact market liquidity
- **Internalised settlement:** settlement internalisers – any institution which executes transfer orders on behalf of clients or on its own account other than through a securities settlement system – will have to report (starting July 2019) to the national competent authority of their place of establishment, on a quarterly basis, the aggregated volume and value of all securities transactions which they settle outside securities settlement systems
- **Provision of banking services:** the additional prudential rules for CSDs may result in a clearer separation between infrastructure functions and banking services
- **Harmonisation and shortening of settlement cycles:** this could lead to further use of standardised settlement messaging services
- **Mandatory LEI (Legal Entity Identifier) use:** the mandatory use of LEI should facilitate record keeping, as well as notary and settlement activities

BNP Paribas Securities Services' view

- We believe that this regulation is an important step forward for safer and more integrated post-trade infrastructures and for efficiency of security settlement. It is a crucial element of T2S' success.
- While we support the newly defined settlement discipline framework as it aims to reduce settlement fails without jeopardising market liquidity, we believe settlement discipline rules require strong adaptation from all market participants. We are actively participating in ensuring effective implementation of this new framework and are working on how to assist clients with this matter.

KEY DATES

AUGUST 2014
Publication of CSDR in the Official Journal

17 SEPTEMBER 2014
CSDR entered into force

MARCH 2017
Publication of level 2 measures (excluding settlement discipline) in the Official Journal

SEPTEMBER 2017
Deadline for CSDs to apply for re-authorisation

MAY 2018
Publication of European Commission delegated acts on settlement discipline

MARCH 2019
Entry into force of level 2 legislation on the calculation of cash penalties and internalised settlement

SEPTEMBER 2019
Start of the revision process of level 1 legislation

SEPTEMBER 2020
Entry into force of settlement discipline rules

EUROPEAN MARKET INFRASTRUCTURE (EMIR)

The European Market Infrastructure Regulation (EMIR) is Europe's response to the G20 commitment to regulate over-the-counter (OTC) derivatives markets in the aftermath of the financial crisis.

ABOUT EMIR

In Europe, the execution of OTC derivatives is regulated under the Markets in Financial Instruments Directive (MiFID II/R) whereas EMIR settles issues relating to central clearing, bilateral margining and reporting. Corresponding measures in the United States are set forth in the Dodd-Frank Act (Title VII).

EMIR aims to:

- Reduce systemic risk and increase transparency in the OTC markets
- Impose central clearing for standardised, sufficiently liquid OTC derivatives, mandatory bilateral margining for certain non-centrally cleared OTC derivatives and reporting to Trade Repositories (TRs) of all derivative trades
- Regulate central counterparties (CCPs) and trade repositories (TRs)
- Allow interoperability among CCPs for equity and bond clearing

SCOPE

- **All financial counterparties** (FCs) including banks, brokers, asset managers and insurers and certain **non-financial counterparties** (NFCs) consisting mainly of corporates. EMIR makes a distinction between NFC+, with pre-defined activity thresholds identical to FCs, and NFC-, with turnover volume below certain thresholds

EMIR focuses on OTC derivatives with several key initiatives:

- Clearing obligations for sufficiently liquid and standardised OTC derivatives
- Risk mitigation techniques for non-centrally cleared OTC derivatives (bilateral margin, portfolio reconciliation, trade confirmation and dispute resolution mechanisms)
- Mandatory reporting of all derivatives transactions to a TR

EMIR also regulates EU CCPs for all financial instruments cleared (including listed derivatives and cash equities), and TRs. All EU CCPs must follow an authorisation process via their national competent authorities. Non-EU CCPs also need to be recognised by ESMA as "qualifying CCPs", provided that the European Commission (EC) has made an equivalence determination for the jurisdiction where the CCP is domiciled.

INDUSTRY IMPLICATIONS

EMIR has had an impact on the way financial and non-financial participants operate their OTC derivative contracts.

- **Collateral requirements significantly increase** for all participants, due to CCP mandatory clearing for sufficiently liquid and standardised OTC derivatives and mandatory margin requirements for non-centrally cleared OTC derivative trades
- In addition, **operational complexity and collateral protection** require consideration and the development of adequate legal and operational frameworks
- All counterparties (with no exception) must report their derivative transactions to a TR and thus **develop reporting solutions**. However, the ongoing revision of EMIR may alleviate the reporting burden for NFC

CCPs must implement certain new requirements:

- The authorisation process with national competent authorities and/or ESMA
- Rules on internal organisation and risk management procedures
- Segregation and portability

As a result of EMIR, clearing brokers must adapt by disclosing fees and costs, and by providing adequate account segregation and protections for collateral.

REGULATORY REVISION

In May 2017, the EU Commission published the first part of the **EMIR review proposal** (also known as **"EMIR REFIT"**). It aims to improve the functioning of the derivatives market in the EU and provide simpler and more proportionate rules for OTC derivatives.

In parallel, in June 2017, the EU Commission issued the second part of the EMIR review (also known as **EMIR 2.2**), concerning CCP supervision in the EU and third-country CCPs seeking access to the EU.

BNP Paribas Securities Services' view

- The first part of the EMIR review (EMIR REFIT) will not alter the key EMIR provisions, namely the clearing mandate and the bilateral margin obligations, which have recently been implemented. However, it could be beneficial in rationalising and optimising requirements and by making obligations more proportionate; but it should remain limited in scope and avoid unnecessary costs for the industry.
- The second part of the EMIR review (EMIR 2.2), which sets new regimes for the supervision of the EU CCPs and the authorisation of third-country CCPs, could be quite consequential for the industry if they are applied to non-EU CCPs. BNP Paribas' position is that the interests and integrity of the EU financial industry should play a primary role in all supervisory decisions, including those relating to third-country CCPs.

KEY DATES

AUGUST 2012
EMIR legislative process is finalised and the regulation enters into force

MARCH 2013
Start date for effective implementation with risk mitigation techniques for non-centrally cleared OTC derivatives

MAY 2017
European Commission proposal for EMIR REFIT

JUNE 2017
Second European Commission proposal for EMIR review (EMIR 2.2) – CCP Supervision package

2017 TO 2020
Phased-in implementation of margin requirements for non-centrally cleared OTC derivatives

JANUARY 2019
End of trilogue negotiations on EMIR REFIT and start of the trilogue negotiations on EMIR 2.2.

Q2 2019
Expected entry into force of EMIR REFIT

INSTITUTIONS FOR OCCUPATIONAL RETIREMENT PROVISION (IORP)

IORP II is the key European regulation for workplace pension funds, replacing the 2003 IORP Directive. IORP II entered into force in January 2019.

ABOUT IORP II

IORP II updates the 2003 IORP *(Institutions for Occupational Retirement Provision)* Directive. IORP II regulates **workplace private prefunded pension schemes** in the second pillar of the national pension system in EU Member States. IORP II has four key objectives:

- Ensures sound workplace pensions and better protection for members and beneficiaries
- Ensures better information for members and beneficiaries (primarily through the Pension Benefit Statement)
- Removes certain obstacles to cross-border provision of services
- Encourages long-term investment in growth, environment and employment enhancing activities

It should be noted that IORP II does not cover solvency capital requirements.

SCOPE

IORP II focuses on increasing **member protection by improving governance and transparency.**

The three key requirements are:

- Conducting an own risk assessment on a regular basis and proportionate to the organisation and to the complexity of its activities
- Introduce a comprehensive communications framework with members of the pension plan mirroring the full life cycle of the employee's pension relationship and to include an annual Pension Benefit Statement *(PBS)*
- Relaxing current investment rules. Member States will no longer be allowed to restrict IORPs from investing in long-term instruments. In addition, Member States will not be allowed to set additional investment rules for IORPs with cross-border activities

Importantly, the Directive encourages IORPs to take into account **Environmental, Social and Corporate Governance (ESG) factors** by requiring:

- Members States to allow IORPs to take into account ESG factors and to invest for the long-term while meeting the Prudent Person Rule
- IORPs to take ESG factors into account as part of their governance and, in a proportionate manner, as part of their risk management
- IORPs to explicitly disclose how an investment policy takes ESG factors into account, in the Statement of Investment Principles (a document made public and reviewed at least every 3 years) and the information provided to prospective members

An IORP may meet these requirements by stating that ESG factors are not considered in its investment policy and that the costs of monitoring ESG are disproportionate to the nature, scale and complexity of the organisation's activities.

However, in the context of the Sustainable Finance Action Plan of the European Commission, the proposal for a regulation on disclosures relating to sustainable investments and sustainability risks will be applicable to IORPs. The proposed regulation empowers the EU Commission to adopt delegated act to prescribe how IORPs should integrate sustainability in investment decisions. It also introduces the obligation for IORPs (alongside the institutional investors) to disclose information on their website on how ESG risks are integrated in investment decisions, on their potential impacts on returns and on how remuneration policies are consistent with sustainability risks and investments.

INDUSTRY IMPLICATIONS OF IORP II

IORP II sets common standards to improve the protection of pension fund members by new governance requirements, new rules on IORPs own risk assessments, new requirements for a depositary and enhanced powers for supervisors.

The Directive is a minimum-harmonisation text which leaves **room for national interpretation**. This is primarily due to the fact that there is no level 2 text, although EIOPA published on 13 November 2018 its guidance and principle on Pension Benefit Statement (PBS) addressed to national regulators responsible for the implementation of IORP II.

Data remains perhaps the biggest challenge when implementing IORP II and in particular:

- the risk evaluation for pensions
- the annual PBS pension which must include pension benefit protections under a best estimate and unfavourable scenario

Depending on the level of implementation at national level, IORP II implies some changes in the content and format of information for members, and consequently in IT systems that support production of existing documents.

As a result, IORP II has the potential to accelerate the consolidation of the occupational pension sector.

BNP Paribas Securities Services' view

- We believe IORP II strikes the right balance between the need for the pensions industry to further develop high standards with regard to governance, supervision, information and transparency.
- Regulatory initiatives adopted in the context of the Sustainable Finance Action Plan of the European Commission reinforce the harmonisation of the definition of sustainability risks, sustainable investment and disclosure obligation and, in that context, should create needs for additional data to be provided.
- It is also worth noting that, in parallel, EIOPA keeps issuing guidelines and conducting stress tests. In its last report published in December 2017, EIOPA concluded that defined benefit/hybrid IORPs have in aggregate insufficient assets to cover their liabilities. EIOPA's next stress test in 2019 should further assess the impact of IORPs on financial stability.

KEY DATES

MARCH 2014
The Commission published a text proposal

OCTOBER 2016
Final text voted in plenary session

DECEMBER 2016
Directive published in the Official Journal of the EU

DECEMBER 2017
EIOPA published its report on stress test

MAY 2018
The European Commission published its proposal for a regulation on disclosures on sustainable investment and sustainability risks

NOVEMBER 2018
EIOPA published guidelines and principles on the PBS

JANUARY 2019
Entry into effect of the IORP II Directive

MID 2019
EIOPA to perform a stress test to further explore the impact of IORPs on financial stability and ESG aspects

MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE REGULATION (MiFID II/MiFIR)

MiFID II/MiFIR entered into force on 3 January 2018 and is primarily aiming at creating greater market transparency and increasing investor protection.

ABOUT MiFID II/R

- The Markets in Financial Instruments Directive 2004/39/EC (MiFID I) was adopted in 2004, entered into force in 2007, and is regarded as the constitution for European financial markets
- The revision of MiFID comprises 2 texts: MiFID II, a directive requiring national transposition, and MiFIR, a regulation that is directly applicable

The revision primarily **aims to create greater market transparency** (partly by redressing the unintended consequences of MiFID, such as fragmentation of the trading environment and dark trading) **and to increase investor protection**.

- The provisions of MiFID II are far-reaching. They include harmonised rules on the authorisation and supervision of investment firms, an EU-passport regime for investment firms, rules on the conduct of business, on investor protection, market transparency and the functioning of trading platforms
- Entry into force was on 3 January 2018

SCOPE

- MiFID II applies to **a broad range of financial services firms** providing investment services in the EU, including investment firms, market operators, and data reporting services providers. It also applies to other financial entities engaging in the provision of investment services, such as banks, insurers and asset managers. These other types of entities are explicitly scoped-in if they perform any MiFID activities
- MiFID II provides an exhaustive list of **regulated activities**. These are divided into **investment services and ancillary services**. Investment services include execution of orders, trading on own account, reception and transmission of orders (RTO), investment advice and, as well as individual portfolio management. Custody and safekeeping of assets are defined as ancillary services
- MiFID II provides an exhaustive list of **financial instruments to which it applies**, including all securities credited to securities accounts and virtually all types of derivative contracts, as well as structured deposits

INDUSTRY IMPLICATIONS

- **Market Infrastructure:** new trading obligations for equities and derivatives intend to restrict OTC trading, **which impacts price formation and market liquidity**. BCNs (Brokers Crossing Networks) and other OTC dark pools have to convert into MTFs (Multilateral Trading Facilities), OTFs (Organised Trading Facilities) or SIs (Systemic Internalisers). Entities involved in international trade may rely on equivalence decisions for third country trading venues in instruments subject to the trading obligation in the EU (e.g. Equivalence decision with the US on 16 November 2017)
- **Distribution:** MiFID II distinguishes between independent and non-independent investment advice. Inducements may still be used for the latter, but only under strict conditions. As a result, both manufacturers and distributors need to review the structure of their value chain for any hidden or obvious inducements and ensure that they meet strict format requirements (e.g. the KID should be no longer than three sides of A4 paper)

  Manufacturers and distributors have to ensure that a series of relevant product information, including detailed disclosures on ex-ante and ex-post costs and charges, are timely disclosed to investors. Also, each product must have a pre-determined target market and should essentially not be distributed outside that target market
- **Transaction reporting:** the scope of reportable transactions (to national authorities) is significantly extended and also includes derivatives. This may result in double reporting requirements under EMIR and MiFIR
- **Open access to clearing:** open access provisions will be fully in force after the end of the transitional period. Thereafter, grounds for denying access (a trading venue to a CCP or vice versa) will only be permitted on the basis of risk to the orderly functioning of the market, liquidity fragmentation, or a lack of commercial viability

BNP Paribas Securities Services' view

- **MiFID II/R represents a drastic change for all market participants.** Without doubt it represents a **regulatory push towards more transparency. This in itself is quite revolutionary and has yet to reveal whether it will oil or stall overall market liquidity and efficiency.**
- **MiFID II/R cannot be viewed in isolation of other EU regulations**, as these are often interrelated. Thus MiFID II is activity-related, PRIIPs is product-related; UCITS and AIFMD regulate collective investments management, transaction reporting of all derivatives is required under EMIR, whereas only certain derivatives must be reported under MiFIR. **It is therefore crucial to navigate the complete web of EU financial regulations.**
- MiFID II/R aim at generalising safeguards and protections for all categories of clients, be they retail or professional. **This requires far-reaching changes** not only from entities dealing directly with end investors, but also from providers working with institutional clients and peers, who are usually "professional".
- We are now in the implementation phase as MIFID II/R went live in January 2018.

KEY DATES

NOVEMBER 2007
MiFID enters into force

OCTOBER 2011
The EC publishes legislative proposals for the MiFID review

JUNE 2014
The final MiFID II and MiFIR texts bare published in the Official Journal

THROUGHOUT 2016
Publication of most delegated acts by the European Commission on technical standards (for implementing measures)

Q3 2016-Q2 2017
Publication of ESMA Guidelines

JULY 2017
Deadline for the national transposition of MiFID by the Member States

JANUARY 2018
Official effective date of MiFID II

JULY 2020
Official entry into force of open access provisions

MONEY MARKET FUNDS REGULATION (MMFs)

Money Market Funds (MMFs) are an important source of short-term financing for financial institutions, corporates and governments. MMFs are one of the five workstreams identified by the FSB (Financial Stability Board) in 2012 in relation to the Shadow Banking System.

ABOUT MMFs

On 30 June 2017, the MMFs regulation was published in the Official Journal of the EU. This regulation has two key objectives:

- Enhance financial stability within European markets by preventing the risk of contagion potentially transmitted by the "run" of MMFs to money markets and to their sponsors (mainly financial institutions)
- Increase investor protection by reducing the disadvantages for late redeemers in stressed market conditions

This regulation introduces:

- **New risk management requirements** which impose stress testing and internal processes to determine credit quality for money market instruments, and "Know Your Customer" policies and procedures
- **New liquidity management requirements** for Public Debt Constant Net Asset Value **(CNAV)** and Low Volatility Net Asset Value **(LVNAV)** MMFs. External support to guarantee the liquidity of an MMF or to stabilise its NAV are prohibited
- **New transparency requirements to investors and competent authorities**

Level 2 and level 3 texts have completed the MMF regulation as regards:

- Cross-reference to criteria identifying simple, transparent and standardised securitisation and, ABCPs in the provisions of the STS securitisation regulation, stress-test scenarios
- Reporting to competent authorities

SCOPE

The MMFs regulation is applicable to all MMF products, whether UCITS or AIFs.

The text classifies MMFs based on their weighted average maturity and life: short term MMFs and standard MMFs.

Moreover, there are three types of MMFs:

- Variable Net Asset Value (VNAV): MMFs which offer unit/share purchases and redemptions at a variable price
- Two types of MMFs which offer unit/share purchases at a fixed price (Constant NAV per unit/share):
  - CNAV MMFs, which invest at least 99,5% of their assets in public debt
  - LVNAV MMFs, whose CNAV per unit/share must not deviate from the NAV per unit/share by more than 20 basis points

The use of the share cancellation mechanism is no longer allowed, as confirmed by the European Commission in its letters dated January 2018 and October 2018 addressed to ESMA.

The regulation expands on the current CESR (Committee of European Securities Regulators) money market fund guidelines published in May 2010 with:

- **New investment requirements to:**
  - Expand minimum daily and weekly liquidity allocations
  - Limit eligible assets, and in particular prohibit the use of short-selling, securities lending, borrowing
  - Limit maximum allocations by non-public issuer counterparty and asset type
- **New valuation rules** which limit the use of amortised cost methods to the calculation of the constant NAV per unit/share

INDUSTRY IMPLICATIONS

Stricter diversification rules could affect the ability of non-public issuers (in particular) to cover their short-term funding needs.

Costs resulting from new requirements could also damage MMF returns. In this respect LVNAV MMFs which publish a CNAV, but do not invest all their assets in public debt, are most impacted by the new constraints as they have to comply with specific liquidity management and reporting requirements.

All MMFs will be affected by more complex risk management and transparency requirements.

Therefore a further concentration of asset managers of MMFs may happen.

BNP Paribas Securities Services' view

- After long debates in both the European Parliament & the Council (notably on rules to be applied to MMFs with CNAVs), the outcome of this negotiation process is a highly regulated and transparent product.
- It significantly strengthens the requirements imposed on money market funds, as compared to other products, in areas such as:
  - Know your customer
  - Credit risk monitoring
  - Liquidity risk monitoring
- New investment requirements could be introduced after 21 July 2022, with the review by the Commission of the regulation and the publication of a report.

KEY DATES

SEPTEMBER 2013
Publication of the draft MMFs regulation by the European Commission, alongside the EC's communication on Shadow Banking

JULY 2014
Adoption of SEC revised rules in the US

JUNE 2017
Publication of level 1 text in the Official Journal

NOVEMBER 2017
Publication of the ESMA report on level 2 texts and level 3 texts

JULY 2018
Entry into application for new funds

JANUARY 2019
Entry into application for existing funds

OCTOBER 2019
Asset managers send their report to their national competent authority

Q1 2020
Start of the obligation for MMF managers to send quarterly reports to national competent authorities

PACKAGED RETAIL AND INSURANCE-BASED INVESTMENT PRODUCTS (PRIIPs) REGULATION

The PRIIPs (Packaged Retail and Insurance-based Investment Products) regulation aims to improve retail investor protection. The scope of market players impacted as PRIIPs' manufacturers is broad and includes asset managers, insurance companies, corporates, banks and futures exchanges.

ABOUT PRIIPs

The PRIIPs (Packaged Retail and Insurance-based Investment Products) regulation aims to improve retail investor protection by:

- Providing basic pre-contractual information via the **introduction of the KID** (Key Information Document)
- Improving the **quality and comparability of information** on the key features of investment products (in particular on risk, performance and costs)

The Regulatory Technical Standards (RTS), published in February 2017 define:

- The uniform presentation of information in the KID to achieve comparability across different types of investment products
- A methodology to harmonise the calculation of the summary risk indicators, performance and costs

The PRIIPs regulation entered into force on 3 January 2018.

In November 2018, the European Supervisory Authorities launched a joint consultation on a targeted review of PRIIPs to avoid the provision by UCITS of both KID and KIID (Key Investor Information Document) from 1 January 2020.

However, rather than a quick fix to address a limited number of issues, the Parliament, supported by the European Commission and the Council, plans to extend the UCITS exemption to provide a KID by two years (until January 2022) and to perform a full review of PRIIPs by the end of 2019.

SCOPE

The PRIIPs regulation includes the following investment products:

- Non-insurance based investment products (where the amounts repayable to the investor are subject to fluctuations because of exposure to reference values or to performance of assets which are not directly purchased by the investor), UCITS, retail AIFs, derivatives, structured securities (such as convertible bonds), pension products and annuities that are not recognised in national law as retirement products, and structured deposits
- Insurance-based investment products (where these allow for fluctuating pay-outs on maturity or early exit): with profit or life insurance contracts with variable bonuses, or which contain unit-linked and index-linked life elements
- Instruments issued by securitisation: Special Purpose Vehicles (SPVs)

PRIIPs manufacturers/issuers must draw up a KID for each product in scope. The KID is to be published on the company website prior to the product being made available to retail investors.

The KID is to be a clearly worded 3-page document, which provides investors with a simple overview of the most important details of the product they are buying including general description of the product, cost, risk profile and possible performance scenarios.

Any distributor or financial intermediary, who sells or provides advice about PRIIPs to a retail investor or receives a buy order on a PRIIP from a retail investor, must provide the investor with a KID.

INDUSTRY IMPLICATIONS

The scope of market players impacted as PRIIPs' manufacturers is broad and includes **asset managers, insurance companies, corporates, banks and futures exchanges.**

At a minimum the following aspects need to be addressed by distributors and manufacturers:

- The distribution process and the respective liabilities of the manufacturer and adviser/seller
- Marketing issues – in particular how to ensure the risk profile and the cost indicators are suitable for the target market
- Defining the content, given the lack of space in the KID (three sides of A4-sized paper)
- The production, dissemination and update of the KID
- The transparency requirements that may overlap between PRIIPs and MiFID II

Apart from having to condense the main features of the product into a restricted space, the main challenge for manufacturers is to determine and to review on a regular basis:

- The four future performance scenarios
- The summary risk indicator
- The costs indicator, which includes implicit transaction costs

BNP Paribas Securities Services' view

- The range of products impacted by PRIIPs has represented a major challenge for the European Supervisory Authorities, particularly in ensuring a level playing field for the various types of products.
- Indeed, the parameters, methodologies, calculations and presentation of risk indicators, performance data, and cost disclosure must not place products at an advantage or disadvantage.
- Key concerns persist on the potentially misleading character of:
  - Transactions costs that capture market movements
  - Future performance scenarios which are based on historical data

KEY DATES

NOVEMBER 2014
Publication of the Level 1 text in the Official Journal

JUNE 2016
Adoption and publication of RTS by the EC

SEPTEMBER 2016
Rejection by the EU Parliament of the draft adopted by the EC

NOVEMBER 2016
The EC extends the application date of the PRIIPs regulation by one year

Q1 2017
Publication of the revised RTS

JANUARY 2018
Entry into application of PRIIPs

END OF 2019
Review of some aspects of the PRIIPs regulation

END OF 2021
Entry into application for UCITS and investment funds which already apply UCITS KIID rules

SECURITIES FINANCING TRANSACTIONS REGULATION (SFTR)

Securities Financing Transactions Regulation (SFTR) is the key European regulation covering securities lending, repos, sell/buy-back transactions and TRS. Phased-in from mid-2016, this regulation aims to regulate the reporting and the transparency of Securities Financing Transactions (SFTs).

ABOUT SFTR

In 2011, the Financial Stability Board (FSB) began its work on "shadow banking" i.e. financing provided other than by credit institutions. The FSB identified securities financing transactions (SFTs) as sources of financing that could be provided in parallel to traditional banking, but required better regulation.

Broadly speaking, SFTs are transactions where securities are used to borrow cash or other securities. They include securities lending, repurchase agreements (repos), and similarly collateralised operations consisting of a transfer of ownership.

In January 2014, the European Commission (EC) published its proposal to regulate the reporting and transparency of SFTs. The ensuing Securities Financing Transactions Regulation (SFTR) is part of the EU's implementation of the global effort made to regulate shadow banking.

In its proposal, the EC focused on **transparency requirements**, notably:

- SFTs must be reported to an EU-approved trade repository (TR)
- Management companies of UCITS and AIFs must inform investors of their use of SFTs, as well as other financing structures, in timely reports
- The SFTR contains a provision that requires the reuse of collateral to only take place with the express knowledge and consent of the providing counterparty. This provision applies to all collateralised obligations, not only to SFTs, each time the receiving counterparty has a right to re-use

In December 2018, the EC finally adopted a series of Delegated and Implementing regulations (RTS & ITS) on TRs regarding: (i) details of the application for registration as a TR; (ii) details of the application for registration and extension of registration as a TR; (iii) provisions on access to data held in TRs; (iv) format and frequency of reports; (v) the procedure and forms for exchange of information on sanctions, measures and investigations; (vi) the collection, verification, aggregation, comparison and publication of data on SFTs by TRs; (vii) fees charged by ESMA to TRs; and (viii) details of SFTs to be reported to TRs.

SCOPE

The SFTR applies to:

- **Any counterparty to a securities financing operation** that is established in the EEA (including all its branches irrespective of where they are located) or established in a third country if the SFT is concluded in the course of the operations of a branch in the EEA of that counterparty
- **Trade repositories**, that need to be authorised under given conditions
- **UCITS investment companies and AIFMs** in relation to the obligation to publish their use of SFTs in their half-yearly and annual reports
- Any **counterparty engaged in the re-use** of financial collateral, where that counterparty is domiciled in an EU member state or, under certain conditions, where a counterparty is domiciled outside the EU

Entry into force is phased in.

INDUSTRY IMPLICATIONS

Once fully in force, **all instruments falling into scope will need to be declared** to an EU trade repository. This is in addition to any requirement to declare transactions that occur under EMIR and MiFID II/MiFIR and is part of a general move to increase transparency in capital markets.

Costs linked to the new disclosure requirements for buy-side are not to be underestimated and may influence their use of SFTs.

SFTs' counterparties have had to review their existing contracts to meet the requirements of Article 15 which concern transparency of the re-use of collateral.

BNP Paribas Securities Services' view

We welcome this initiative as it brings greater transparency as well as much-needed traceability of securities re-use (both SFTs and securities transfers). The obligation to debit and credit securities accounts can be read in conjunction with other legislation related to asset protection, such as the Financial Collateral Directive and the Settlement Finality Directive.

KEY DATES

JANUARY 2014
Initial proposal for a regulation

MID-DECEMBER 2015
Publication in the Official Journal of the EU

JANUARY 2016
Entry into force of level 1 text (except for provisions subject to phased-in implementation)

JULY 2016
Entry into force of transparency requirements on re-use of collateral

JANUARY 2017
Start date for disclosure to end investors on use of SFTs by UCITS funds and AIFs

APRIL 2017
ESMA final advice to the EC on the Regulatory Technical Standards on reporting of SFTs to TRs

JULY 2017
Start of phase in for disclosure requirements for managers of AIFs

DECEMBER 2018
Publication by the EC of Delegated and Implementing acts

APRIL 2020
Start date of the SFT reporting obligation to TRs for Financial counterparties

SUSTAINABLE FINANCE ACTION PLAN

On 8 March 2018, the European Commission (EC) published its Sustainable Finance Action Plan which aims to channel more funding to sustainable economic activities and firstly to activities that will mitigate the climate change or contribute to the adaptation to climate change.

ABOUT THE SUSTAINABLE FINANCE ACTION PLAN

In May 2018, a first legislative package was published by the EC which includes proposals for European Union (EU) taxonomy of sustainable economic activities, disclosure requirements on sustainability consideration for financial products and the definition of two low-carbon benchmarks.

The key initiatives of the EC Sustainable Finance Action Plan are:

- Creating a EU classification (taxonomy) of environmentally sustainable economic activities as well as EU standards and green labels based on this EU taxonomy
- Strengthening sustainability disclosures by companies
- Taking into consideration:
  - Sustainability when defining targeted investors of financial instruments
  - Investor's environmental, social or governance preference when they are advised by investment firms and insurance distributors
  - Sustainability into risk management and disclosure for institutional investors and asset managers
- Incorporating sustainability in prudential requirements
- Considering mandating credit rating agencies to explicitly integrate ESG factors into their assessment
- Improving accounting rule-making

SCOPE

The action plan will introduce:

- Through the EU taxonomy regulation, a list of economic activities that substantially contribute to the six environmental objectives, the two first being climate change mitigation and adaptation. To be marketed as "environmentally sustainable", a financial product would need to invest a proportion of its holdings in taxonomy compliant economic activities, higher than a certain threshold
- More transparency on sustainability consideration for:
  - Companies: by Q2 2019, the Commission will revise the guidelines on non-financial information building on the metrics developed by the Commission Technical Expert Group (TEG) on sustainable finance. The EC will also publish its conclusion on the fitness of EU legislation on EU corporate reporting including the evaluation of sustainability reporting requirement
  - Manufacturers of financial products (insurers, asset managers, pension funds, portfolio managers): they will be subject to new disclosure requirements on sustainability under a regulation for disclosure on sustainable investments
  - Administrators of ESG benchmarks: they will have to disclose their methodology. The delegated acts under the Benchmark Regulation will define harmonised methodologies for two types of low carbon benchmarks
- The obligation for insurers, asset managers, investment firms, pensions funds – through amendments of delegated acts under the UCITS Directive, AIFMD, MiFID II, Solvency II and the Insurance Distribution Directive (IDD) – to consider sustainability risks as part of their risk management process
- The obligation, for investment firms and distributors of insurance-based products, to ask their investors their ESG preferences when performing suitability assessment
- ESG consideration in prudential regulation for banks and insurers

INDUSTRY IMPLICATIONS

Many of the regulatory initiatives of the first legislative package are progressing simultaneously and their structuring concept definitions are still being discussed by the policymakers particularly the use of the taxonomy. Therefore, it is still not clear whether financial products that invest in environmentally friendly economic activities that are not EU taxonomy compliant will still qualify as a financial product with ESG characteristics.

Although corporates, institutional investors and banks welcome the sustainable finance action plan, they are concerned by potential costs to provide or to access necessary data to comply with new requirements on transparency and risk management. Banks are also concerned on whether incorporating sustainability in prudential requirements should translate by the introduction of a Green Supporting Factor, that would decrease capital charges for green assets, or, on the contrary, the introduction of Brown Penalty that would increase capital charges for high carbon assets.

BNP Paribas Securities Services' view

For now investors tend to invest in pure green activities by lack of technical criteria when it comes to environmentally sustainable funds. For example, they tend not to invest in gas, or automobiles in any of their green funds. The proposed taxonomy should help investors identify which technologies/ ways of conducting an activity are good for the transitioning to a more sustainable economy and will broaden the scope of investment options. The taxonomy's technical criteria should allow for the inclusion of economic activities that may continue to have negative impacts on the environment, but that are on course to substantially reduce them.

KEY DATES

24 MAY 2018
Publication by the EC of the legislative package

7 DECEMBER 2018
TEG published its first draft taxonomy

19 DECEMBER 2018
The European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA) published consultations on the integration of sustainability factors in delegated acts of the UCITS Directive, AIFMD, MiFID II, Solvency II, IDD

APRIL 2019
Technical advice of EIOPA and ESMA on integration of sustainability factors is expected

JUNE 2019
TEG report on taxonomy for economic activities that contributes to climate change mitigation and adaptation

REVISION OF THE SHAREHOLDER RIGHTS DIRECTIVE (SRD II)

The Shareholder Rights Directive (SRD I) entered into force in 2007. The original directive and its revision (SRD II) form part of the European Commission's (EC) Corporate Governance Action Plan 2012. The Directive 2017/282 on Long Term Shareholder Engagement, the new denomination of the Shareholder Rights Directive, was published on 17 May 2017.

ABOUT SRD II

SRD should be read in combination with the market standards for General Meetings as well as the Commission Implementing Regulation of 3 September 2018 which introduces transmission deadlines for issuers and intermediaries in corporate events and in the shareholder identification processes.

SRD II aims to stimulate **shareholders' long-term engagement,** increase **transparency in the voting process** both in relation to proxy voting and shareholder identification; and improve **issuer-investor dialogue**.

- Shareholder identification: issuers have the right to obtain shareholder identification with the objective of engaging directly with the investor
- Say on pay: issuers must draw up an annual remuneration report, providing a comprehensive overview of the remuneration, including all benefits in whatever form, awarded or due during the most recent financial year to individual directors. Voting on remuneration must take place during the General Meeting of shareholders
- Some transactions, including intragroup transactions – between a company and its affiliates or between two affiliates of the same holding company – must be approved at the General Meeting
- Investment strategy: institutional investors, such as asset managers, pension funds or insurance companies, must establish an investment strategy and publish associated reports in a timely fashion
- Transparency of proxy advisors: proxy advisors should establish accurate and reliable voting recommendations. Proxy advisors will have to publish a report on their compliance with the code of conduct of proxy advisors

SCOPE

SRD II focuses on **investors and shareholders**. In a nutshell, their **identities will be disclosed** when they hold more than a threshold share of issued capital. By default, this threshold is set at 0.5% of an issuers' capital but Member states may opt out of this threshold. Investors and shareholders will have **increased rights in General Meetings**, as well as **access to investment strategy** information (when they are institutional investors) and have far better **visibility into proxy advisors** and how they establish voting instructions.

Through these provisions, other constituencies will be impacted:

- Issuers of listed companies will be able to obtain shareholder identification
- Shareholders will have greater powers at General Meetings
- Custodians and other intermediaries will have to cooperate in the identification process
- Proxy advisors will be subject to increased transparency obligations

INDUSTRY IMPLICATIONS

Increased transparency at all levels (identification, voting decisions, and investment policy) could lead to more dialogue between issuers and their shareholders.

Institutional investors will need to establish an investment strategy, asset managers will be subject to transparency and disclosure requirements on a half-yearly basis and issuers will have to comply to stricter rules like the 0.5% threshold, the provision of information relating to the exercise of rights to intermediaries and the obligation to confirm the votes cast in general meetings by or on behalf of shareholders.

Combined with other initiatives of the Capital Market Union initiative, and in particular the Sustainable Action Plan, the revision of the Shareholders' Rights Directive should lead to longer-term engagement and investment in issuing companies.

BNP Paribas Securities Services' view

- We warmly welcome this initiative.
- Whilst increased transparency is beneficial to the overall objectives of the European Commission, we think that a balance should be reached regarding the efficiency of General Meetings. Thus, "say on pay" provisions should be realistic and the increased approval powers of related transactions should not be an unnecessary burden on the conclusion of such transactions.
- In relation to shareholder identification, we think that a regime without exceptions and subject to effective sanctions against failure of identification is the only efficient approach. Procedures could otherwise become an excessive burden for intermediaries. From an issuers' perspective, it could lead to a paradox where shareholder rights are increased but opacity in the shareholder base is introduced.

KEY DATES

APRIL 2014
Publication by the EC of its proposal for the revision of SRD

APRIL 2017
Adoption by the EU Council of the Directive on Shareholder's rights in EU companies

MAY 2017
Publication in the Official Journal of the Directive with regard to the encouragement of long-term shareholder engagement

SEPTEMBER 2018
Publication by the EC of the Commission Implementing Regulation (EU) 2018/1212

JUNE 2019
Member States must inform ESMA on whether they opted out of the 0.5% threshold

Q2 2019
The European Commission will publish its guidelines on the remuneration report

JULY 2019
Entry into force of SRD II

SEPTEMBER 2020
Deadline for implementation of shareholder identification, transmission of information and voting

UNDERTAKINGS FOR COLLECTIVE INVESTMENTS IN TRANSFERABLE SECURITIES (UCITS V)

The UCITS V Directive focuses heavily on increasing investor protection for UCITS (Undertakings for Collective Investment in Transferable Securities) funds, given that these are sold to the general public.

To this effect, the UCITS V Directive (UCITS V) is globally aligned with the Alternative Investment Fund Managers Directive (AIFMD) on rules concerning asset manager remuneration and the duties and liabilities of depositaries. However UCITS V imposes a stricter depositary regime and also introduces a harmonised sanctions regime.

ABOUT UCITS V

Key changes compared to AIFMD lie in the following provisions:

- The independence requirement between the UCITS asset manager and the depositary (i.e. independence between their respective governance bodies)
- The insolvency protection regime when the custody function has been delegated by the depositary although recent amendments of AIFMD delegated acts on safekeeping duties of depositaries, which will entry into application in April 2021 will remove this gap between AIFMD and UCITS V

Key changes compared to UCITS IV are:

- The introduction of stricter criteria for entities allowed to act as a depositary (now restricted to credit institutions, national central banks and other legal entities authorised under the laws of EU Member States to carry out depositary activities and subject to harmonised additional conditions under UCITS V)
- The obligation for the depositary and the asset manager/UCITS fund to enter into an agreement whose content is specified in the level 2 text
- For depositaries, the strict liability regime for assets held in custody and the introduction of new duties: cash monitoring, record-keeping for assets not held in custody and oversight duties for UCITS funds which have a legal personality

SCOPE

- EU asset managers managing UCITS funds
- UCITS depositaries

INDUSTRY IMPLICATIONS

New remuneration rules have forced asset managers to adapt their remuneration policy. The industry has expressed concern over the overlapping requirements for EU-wide portfolio management activities between UCITS V, AIFMD, MiFID and the Capital Requirement Directive (CRD IV) and the need for proportionality.

When appointing a depositary, asset managers must also:

- Ensure compliance regarding depositary selection with respect to eligibility criteria and independence requirements
- Implement required information flows and contractual arrangements with depositaries

Since the entry into effect of UCITS V, segregation requirements and the role of investor CSDs have been interpreted in different ways at the national level. The same issue exists with AIFMD.

On 20 July 2017 ESMA published an opinion on these topics. This opinion, which is not binding, sets out suggestions to the EU institutions for possible clarification of the legislative provisions under AIFMD and the UCITS Directive. Subsequently, on 30 October 2018 amendments of UCITS V delegated acts on safekeeping duties of depositaries were adopted. At the depositary's delegates level, the use of omnibus accounts including assets of AIFs, UCITS and other clients will be allowed. In counterparty, due diligence and verifications by the depositary all along the custody chain are strengthened and the depositary must keep a record for each UCITS in its book for the assets whose custody has been delegated.

BNP Paribas Securities Services' view

- We welcome the harmonisation and clarification of depositary functions/liabilities introduced by UCITS V and the increase of investor protection it brings. UCITS V enhances the UCITS brand and may provide marketing opportunities.
- However, UCITS V is challenging for smaller depositaries given their duties and stricter liabilities.
- Asset managers offering UCITS need to appoint a secure depositary given that:
  - The depositary is liable for any loss caused by its sub-custodians, and obliged to restitute the assets lost
  - UCITS V provisions on sanctions reinforce the importance of the oversight function performed by the depositary
- With the new Commission to be put in place in Q2 2019, the UCITS legislative framework could be reviewed, together with AIFMD. In particular, EU regulators are expected to seek further harmonisation on the following issues:
  - Definition of share classes
  - Diversification requirements on non-cleared OTC derivatives

KEY DATES

MARCH 2016
UCITS V Directive implementation date

ESMA published guidelines on asset managers' remuneration

OCTOBER 2016
Level 2 text provisions entered into effect

JANUARY 2017
Entry into application of the guidelines on asset managers' remuneration

JULY 2017
ESMA opinion on asset segregation rules along the custody chain and the clarification of the role of investor CSDs

OCTOBER 2018
Amendments of UCITS V delegated acts on safekeeping duties of depositaries

JANUARY 2019
Start of the trialogue on cross-border distribution of funds

APRIL 2020
Entry into application of the new safekeeping duties for depositaries

02

REGULATIONS IN ASIA AND PACIFIC

ASEAN COLLECTIVE INVESTMENT SCHEME (ASEAN CIS)

Under the ASEAN CIS framework, the units of a fund authorised in one CIS domicile (home jurisdiction) can be offered in other participating countries (host jurisdictions) upon approval by home and host regulators. The participating regulatory bodies are: the Monetary Authority of Singapore, the Securities Commission of Malaysia and the Securities and Exchange Commission of Thailand.

ABOUT ASEAN CIS

The ASEAN CIS framework is an initiative from the ASEAN economic community, which aims to establish a single market and production base with a free flow of goods, services, investments, skilled labour and a free flow of capital.

Under the ASEAN CIS framework, the units of a fund authorised in one CIS domicile (home jurisdiction) can be offered in other participating countries (host jurisdictions) upon approval by home and host regulators.

The participating regulatory bodies are: the Monetary Authority of **Singapore**, the Securities Commission of **Malaysia** and the Securities and Exchange Commission of **Thailand**.

Guidelines for participation are detailed in two key documents: The Standards of qualifying CIS and the Handbook for CIS operators of ASEAN CISs.

Key requirements for related parties

- An ASEAN CIS operator must have at least: five years of experience in managing collective investment schemes, USD 350 million of assets under management globally, shareholder equity of USD 1 million and maintain specified capital adequacy. It must also undertake to submit to the non- exclusive jurisdiction of the host jurisdiction's courts
- The trustee and fund supervisor must be domiciled and regulated in the same jurisdiction as the ASEAN CIS operator
- Local distributors must be regulated or licensed by the host regulator
- An independent party is required for valuation and NAV calculation

Key fund requirements

- Funds must be assessed as suitable for cross-border distribution by the home regulator
- Funds can only invest in specific assets classes: transferable securities, money market instruments, deposits, units of other CISs and financial derivatives
- Up to 100% of a fund's assets may be delegated to a sub-investment manager not regulated by any of the participating countries, conditional on the home regulator's approval
- Additional rules apply for money market funds, master feeder funds, funds of funds and exchange-traded funds

SCOPE

Asset managers with authorised CIS funds in Singapore, Malaysia and Thailand who want to raise assets from retail investors within the three participating markets.

INDUSTRY IMPLICATIONS

The ASEAN CIS framework aims to foster cross-border fund distribution and shorten time to market for funds. Local investors will benefit from a wider choice of funds as product expertise is exported to different markets.

This is an opportunity to consolidate management of funds and streamline operating models. In the future, the ASEAN CIS framework may merge with other Asian cross-border fund schemes, like the Asia Region Fund Passport.

Distribution challenges for asset managers

- Currency restrictions in Malaysia and Thailand: onshore
- Responsibility of the CIS operator to appoint suitable representative offices and registrars/transfer agents in host jurisdictions
- Taxation: country specific withholding tax rules, taxation on residents and non-residents, etc.

Compliance and regulatory challenges

- Country-specific requirements such as specific currencies for fund offerings, languages for offering documents, timeframes for the application process, etc.
- Multiple monitoring and reporting procedures in order to be compliant across home and host jurisdictions

BNP Paribas Securities Services' view

- The ASEAN CIS scheme complements the UCITS scheme, allowing asset managers to access traditionally closed fund markets such as Malaysia and Thailand. However, it is imperative that the participating regulators continue to harmonise regulations between the various jurisdictions to reduce the barriers to entry to the ASEAN CIS framework.
- We provide end-to-end solutions (global custody, fund accounting, trustee services, transfer agency, middle office outsourcing, forex solutions and share class hedging) for all types of Singaporean funds eligible under the ASEAN CIS framework.
- We support cross-border distribution in Malaysia and Thailand as well as in Singapore, through our transfer agency's connectivity with local distributors. Our expertise in cross-border distribution extends to Europe, where we have a proven track record.
- We have developed innovative solutions to service RQFII funds and Sharia-compliant funds, that we have identified as potentially benefiting from strong cross-border inflows as part of the ASEAN CIS framework.

KEY DATES

2008
Implementation plan developed to facilitate cross-border offers of CIS

2013
Founding countries signed a memorandum of understanding to establish a cross-border offerings framework for ASEAN CIS

AUGUST 2014
ASEAN CIS framework officially launched

FEBRUARY 2018
Asean CIS Framework revised including relaxed qualification for fund managers

2019
Ongoing discussions to expand the number of signatories, harmonise disclosure standards and relax investment restrictions

ASIA REGION FUNDS PASSPORT (ARFP)

The Asia Region Funds Passport (ARFP) is an initiative led by Asia-Pacific Economic Cooperation (APEC) with the objective of attracting and keeping finance within the region to foster its economic growth, and strengthen the investment management industry. Five countries (Australia, Japan, New Zealand, South Korea and Thailand) signed a Memorandum of Understanding to participate in the ARFP.

ABOUT ARFP

ARFP has been live since 1 February 2019. Japan, Thailand and Australia are ready to receive registration applications from local prospective Passport funds and entry applications from foreign Passport funds. New Zealand and Korea continue to make progress with the legal and regulatory requirements for implementation required in their respective jurisdictions. APEC is continuously promoting the ARFP scheme to other member countries for consideration. Potential new joiners could include India, Indonesia, the Philippines, Singapore and Vietnam (currently observers in the ARFP working group). The ARFP allows units of funds authorised in a participating country (home jurisdiction) to be offered in other participating countries (host jurisdictions) upon approval as an ARFP fund and host jurisdiction authorisation. The ARFP emphasises investor protection by ensuring that participating countries must meet the standards of the International Organization of Securities Commissions (IOSCO).

Key reference documents:

APEC ARFP website: http://fundspassport.apec.org/

Key requirements

The fund must:

- Be constituted or established as a regulated Collective Investment Scheme (CIS) or a sub-fund of a regulated CIS in one of the participating ARFP jurisdictions
- Be distributed in its home jurisdiction
- Have a net asset value of at least USD 500mn
- Only invest in specific asset classes: transferable securities, money market instruments, deposits, depositary receipts over gold, derivatives, units of other funds. Further details are in the ARFP rules document

The fund's operator must have a minimum capital of USD 1mn, plus 0.1% of Assets under Management (AuM) above USD 500mn of AuM, up to USD 20mn. The ARFP commits to a 21-day application review timeline for ARFP eligibility.

SCOPE

Asset managers in participating countries aim to raise capital from retail investors in the Asia-Pacific region using their locally domiciled funds. As of today, the alternative strategies and long short funds are excluded from the scheme. So far, only certain investors in some countries have had direct access to a limited range of foreign funds. For instance, Australia (wholesale investors), Japan and South Korea allow the distribution of UCITS funds.

INDUSTRY IMPLICATIONS

Funds in Asian economies are largely domestic strategy funds. The ARFP will be an excellent opportunity for asset managers to **distribute their unique strategies to new markets**. Local asset managers will face increased competition from foreign asset managers, likely leading to a downward pressure on fees. Retail investors will benefit from a wider range of fund investment products to choose from.

Challenges for asset managers

Currently, **host jurisdictions' rules** significantly differ in areas such as disclosure requirements. In addition, unequal tax treatments between local and foreign funds also hamper foreign fund attractiveness and comparability.

Asset managers also face challenges in managing an effective distribution model such as:

- Currency restrictions in South Korea and Thailand: onshore FX requirements, overall foreign investment quota, foreign currency transaction restrictions
- Fund operator responsibility for appointing suitable local representative, distributor and transfer agent in host jurisdiction(s)
- Tax treatment needs to be harmonised across the participating countries to allow neutrality (at a minimum) between local fund and passported funds
- Distribution via the local channels is also a significant hurdle as this requires distributor education and investment, and online platforms are still in their emerging stage

They also have to choose the most suitable product for the target market(s), avoiding cannibalising sales of local distributor partners and offering competitive fees against local funds.

BNP Paribas Securities Services' view

The ARFP Joint Committee is strongly committed to the success of the ARFP by actively engaging with the industry. We believe that the ARFP forms a good framework to promote cross-border fund distribution in the Asia-Pacific region. The ARFP will complement the existing cross-border distribution schemes in the region such as the UCITS and master-feeder fund structures. Now that ARFP is live since 1 February 2019, we expect to see the first ARFP funds launched within the first half of 2019. Asset managers are likely to take a wait-and-see approach to the scheme. Distributing in a new market requires a long-term commercial strategy, to offset costs incurred by building distributor networks and meeting reporting requirements.

KEY DATES

SEPTEMBER 2013
Signing of ARFP Statement of Intent

SEPTEMBER 2015
Signing of ARFP Statement of Understanding

JUNE 2016
Signing ARFP Memorandum of Cooperation

DECEMBER 2016
Formation of Joint Committee

AUGUST 2017
Third ARFP consultation paper released Guidance for laws and regulations

JANUARY 2018
ARFP pilot programme launched

FEBRUARY 2019
ARFP went live

MID 2019
First ARFP fund expected to be launched

AUSTRALIA CORPORATE COLLECTIVE INVESTMENT VEHICLE (CCIV)

Australia has the largest funds management industry in the Asia-Pacific region. Coinciding with the Asia Region Funds Passport (ARFP), the Corporate Collective Investment Vehicle (CCIV) could present a significant opportunity for the Australian fund management industry to export to the Asia-Pacific region.

ABOUT CCIV

The Treasury of Australia has introduced these new corporate collective investment vehicles which are intended to:

- Enhance the international competitiveness of the funds industry by enabling funds to use vehicles commonly used overseas
- Expand the range of funds offered in Australia
- Maximise the effectiveness of government initiatives, such as the ARFP

The CCIV regime has been structured with recognised features of international collective investment vehicles, such as Undertakings for Collective Investment in Transferable Securities (UCITS). It will be an optional alternative to the existing managed investment scheme (MIS) regime under the Australian Corporations Act.

SCOPE

The new CCIVs will primarily impact Australian fund management firms wishing to offer their investment products to foreign investors.

INDUSTRY IMPLICATIONS

The CCIV will be implemented in Australia through the Treasury Laws Amendment (Collective Investment Vehicle) Bill 2017 (The Bill) and an additional Bill to enact amendments to other legislation, including the Corporations Act.

The CCIV has been designed to:

- Offer shares and dividends, instead of units and distributions common to unit trust structures
- Ensure smooth **integration with the ARFP rules**
- Complement the existing regulatory framework to reduce regulatory arbitrage and compliance costs

Key features

It is anticipated to include **both a retail and a wholesale CCIV**, with the retail vehicle subject to stricter regulatory requirements (similar to the existing managed investment scheme regime).

A company intending to register as a CCIV must be limited by shares.

A CCIV must have an authorised corporate director (ACD), which must be a public company, and hold the necessary Australian Financial Services Licence (AFSL) authorising it to operate a CCIV.

The ACD of a CCIV must act in a similar way to a responsible entity under the existing management investment scheme (MIS) regime.

It introduces the **depositary function** which has three core duties including holding the assets of the CCIV on trust for the CCIV, executing the instructions of the ACD and supervising certain activities of the ACD.

Sub-funds

The new CCIV regime also introduces the concept of sub-funds to the Australian market:

- A CCIV must operate at least one sub-fund and can have multiple sub-funds. These sub-funds will not be separate legal entities
- Sub-funds can offer various investment strategies under the CCIV umbrella. This should provide scale and cost savings for fund managers compared to the managed investment scheme regime
- New sub-funds must be registered with the Australian Securities and Investments Commission (ASIC)
- Assets and liabilities of sub-funds must be kept separate in order to ensure investor protection from the activities of other sub-funds

Depositaries

The depositary requirement for retail funds has been broadly modelled on the UCITS regime where the depositary safeguards the fund assets and has prescribed oversight responsibilities. Some key features of the proposed depositary framework include:

- A depositary is mandatory for a retail CCIV and discretionary for a wholesale CCIV
- The depositary must be a registered public or foreign company, hold an AFSL (authorising it to act as a depositary) and be independent of the ACD
- The depositary is responsible for supervising the corporate director's conduct in relation to prescribed activities including issuing, redeeming and cancelling shares in the CCIV, valuing shares, allocating assets and liabilities to the sub-funds, and allocating and distributing income
- Introduction of a depositary independence test

BNP Paribas Securities Services' view

- BNP Paribas recognises the potential of the CCIV; however, given the scale of the Australian funds management market it is essential that the new CCIV regime is a commercially viable vehicle that existing industry participants are capable of servicing.
- BNP Paribas, together with industry participants has been working with The Treasury to highlight areas of concern in order to assist The Treasury to create a successful and commercially viable CCIV capable of widespread adoption.

KEY DATES

SEPTEMBER 2017
Consultation on the first exposure draft legislation closed

DECEMBER 2017
ASIC released Consultation Paper 296 *Funds management* (CP 226), with comments closed

FEBRUARY 2018
CCIV Tax framework consultation close

JULY 2018
Consultation on the first tranche of the revised legislation closed

AUGUST 2018
Consultation on the second tranche of the revised legislation closed

OCTOBER 2018
Consultation on the third tranche of the revised legislation closed

2019
Bill anticipated to be introduced to Parliament to implement the CCIV

CHINA BOND CONNECT

Launched in 2017, Bond Connect is a mutual market access scheme between Mainland China and Hong Kong's bond markets through a crossborder platform linking their respective financial infrastructures for trading, settlement and custody of China Interbank Bond Market (CIBM) bonds.

ABOUT CHINA BOND CONNECT

Bond Connect complements QFII (Qualified Foreign Institutional Investor), RQFII (RMB Qualified Foreign Institutional Investor), and CIBM Direct Access schemes and is a step further to opening up onshore capital markets to overseas investors. Unlike other schemes, there is no quota requirement or need for investors to identify the intended investment amount.

In late 2017, northbound trading went live, allowing overseas investors to invest directly into the CIBM market through Hong Kong's market infrastructure. Southbound trading is still to be implemented.

SCOPE

The scope of eligible investors under Bond Connect is the same as the CIBM Direct scheme. Through the scheme, the People's Bank of China (PBOC) is encouraging into the market mid- to long-term investors such as commercial banks, asset managers, insurers, securities houses, pension funds, charitable funds and other long-term investors.

INDUSTRY IMPLICATIONS

Registration

Under the Bond Connect scheme, each institution is required to submit an application to the Chinese authorities via the Bond Connect Company Limited (BCCL), which is a joint venture created by the Hong Kong Stock Exchange and the China Foreign Exchange Trading System (CFETS). The PBOC is expected to process and grant approval within 10 calendar days to eligible investors. Once approved, CFETS assigns a unique trading identifier to the investor to begin investing.

Account opening

Offshore investors must have an appointed a local custodian, who is a "Bond Connect Linkage Participant" in the Hong Kong Central securities depository (CSD) which is called the Central Monetary Unit or CMU. This can be via a direct appointment or through the investor's appointed global custodian. BNP Paribas Securities Services Hong Kong is an eligible Bond Connect Linkage Participant and can be appointed in this way. The Bond Connect Linkage Participant will assist in opening a segregated CMU sub-account per investor. Unlike the CIBM Direct scheme, investors are not required to open segregated onshore securities accounts or cash accounts.

Trading

Offshore investors are able to use offshore trading platforms TradeWeb and Bloomberg for placement of orders with onshore participating dealers. As of the end of 2018, offshore investors are allowed to trade with only the 34 eligible onshore participating dealers (including BNP Paribas). Regulators are expected to open access further to allow trading with both onshore and offshore market participants. Since 31 August 2018, investors have the possibility to book trades in bulk across underlying mandates when placing trades through the offshore trading platforms.

Post-trading

Once the trade is matched, CFETS sends the confirmation ticket for settlement to the China Central Depository and Clearing (CCDC) and the Shanghai Clearing House (SCH). The settlement flow is fully managed through the investor's Bond Connect Linkage Participant along with CMU, who holds a nominee account with the two onshore CSDs, namely the CCDC and SCH. The settlement cycle can be T, T+1 or T+2; however, most investors opt for T+2 to ensure the cross-border flow of securities and cash, and T+2 provides extra time for funding. Investors can use CNH (offshore renminbi) or foreign currencies for funding. The regulator has also opened the gate for CNO (onshore renminbi) conversion and hedging; however, forex transactions can only be done via the Bond Connect Linkage Participant and should always be directly linked to the Bond Connect activity.

In August 2018, it was announced that activity settled via CCDC is now on a DVP basis. This was a key enhancement necessary for many investors to enter the market and was a pre-requisite for the Bloomberg-Barclays index inclusion in 2019.

BNP Paribas Securities Services' view

- The Bond Connect scheme offers greater access to onshore Chinese bonds, and greater safeguards and cost effectiveness for overseas investors than previous schemes. Continued upgrades will enhance its place as the most comprehensive China access programme.
- At the market level, regulators and the market operators are expected to continue to improve the Bond Connect operating model and further align the investment options with global standards. We understand that authorities are discussing the possibility of adding repo trading as an option through Bond Connect. In addition, the market is talking about the possibility of investors directly appointing their own FX bank for CNO FX trading (both for hedging and funding purposes). This will continue to be a focus in 2019 to find the right solution that does not jeopardise the safe settlement of transactions.
- As mentioned, 2019 will see the inclusion of Chinese Bonds in a number of global indices starting with the Bloomberg–Barclays Global Aggregate Index planned in April 2019.

KEY DATES

JULY 2017
Launch of Bond Connect (northbound trading)

AUGUST 2018
Real DVP settlement fully implemented across both the Shanghai Clearing House (SCH) and the China Central Depository & Clearing Co., Ltd. (CCDC)

Block trading capability launched

NOVEMBER 2018
3-year exemption (7 Nov 2018 to 6 Nov 2021) announced on income tax and VAT on offshore institutional investors' interest income from domestic bonds

JANUARY 2019
Bloomberg Access is officially launched as the second trading platform for Bond Connect

APRIL 2019
Expected inclusion of Chinese bonds into Bloomberg-Barclays Global Aggregate Index

CHINA INTERBANK BOND MARKET (CIBM DIRECT) REGULATION

Announced in February 2016, the CIBM Direct scheme is a further step in opening up Chinese financial markets to international investors and encouraging them to invest in Renminbi.

ABOUT CIBM DIRECT

The CIBM Direct scheme creates **a route for international investors to access onshore bonds**, complementing long-established QFII and RQFII schemes.

Under the CIBM Direct scheme, foreign institutions can trade bonds directly through banks holding a **Type A licence in Mainland China** (with only six foreign banks including BNP Paribas). The CIBM market can also be accessed via Bond Connect through Hong Kong.

SCOPE

Under the **CIBM** framework, international investors are able to access cash bonds (both rates and credit bonds). The CIBM scheme applies to a **large range of investors**: commercial banks, asset managers, insurers, securities houses, pension funds, charitable funds and other long-term investors approved by **People's Bank of China (PBoC)**.

It defines three categories of investors:

- **Type A investors** (such as BNP Paribas) can trade, settle and provide custody for interbank bond market instruments both for themselves and on behalf of Type C investors
- **Type B investors** can trade and settle in the interbank bond market for themselves, and trade directly with others
- **Type C investors** must appoint a Type A investor for settlement to carry out bond trading on their behalf. As of December 2018, all foreign investors are Type C

Further clarification on CIBM Direct

- There is no restriction on the currency of the investment principal remitted from offshore
- Onshore FX conversion and hedging of FX risk for the CIBM investments are permitted without any pre-approval from SAFE. The FX derivatives available onshore include: FX Forward, Swap, CCS and vanilla options
- Onshore Bond and IR derivatives are permitted for hedging purpose, including Bond Lending, Bond Forward, IRS and FRA
- Master Agreement is needed for entering derivatives onshore:
  - ISDA or NAFMII for FX products
  - NAFMII for IR and Bond derivatives
- Currency ratio control is imposed on funds repatriation to offshore:
  - Where an investor repatriates the funds out of China, the ratio of RMB to FCY shall generally match the original currency ratio when the investment principal was remitted into China, with a maximum permissible deviation of 10%
  - For the initial repatriation, the aforesaid Currency Ration requirement can be waived, provided that the FCY or RMB to be repatriated does not exceed 110% of the FCY or RMB remitted into China in aggregate
  - In case an investor enters the CIBM with one single currency, the first repatriation amount cannot exceed 110%. However, there is no limit starting from the second repatriation

INDUSTRY IMPLICATIONS

Before trading, offshore investors (including those with a QFII or RQFII licence) must appoint an **onshore settlement agent**. The settlement agent submits the two-page filing form.

PBoC will acknowledge the filing within 20 calendar days. The settlement agent manages the account opening on behalf of its clients – on a segregated basis – with the China Foreign Exchange Trade System (CFETS), China Central Depository & Clearing (CCDC) and the Shanghai Clearing House (SHCH). The settlement agent manages the offshore investor's daily transactions and mandatory reporting to regulators (if required).

The CIBM Direct scheme **complements long-established QFII and RQFII schemes** and significantly facilitates access to the Chinese fixed income market for foreign institutional investors:

- Investment quotas are removed under this scheme
- The process is easier: a simple registration to PBoC is required before trading

BNP Paribas (China) Ltd. was granted a Type A licence by PBoC in March 2015 and can provide settlement agent and custodial services for foreign investors (Type C) who have an interest in the China Interbank Bond Market.

BNP Paribas Securities Services' view

- It enables international investors to diversify their fixed income portfolios, and gain access to this rapidly growing and increasingly important market. In addition, as international credit rating agencies are allowed to establish a presence in China since July 2017, foreign investors may be more secure in gauging Chinese corporate debt, which may be complex.
- Foreign institutional investors are able to rely on a single Type A partner – such as BNP Paribas (China) Ltd. – to access the onshore fixed income market. In this role, BNP Paribas (China) Ltd. fully manages the administrative process required to gain access to the scheme and ensure a seamless process from trade execution to settlement and custody.

KEY DATES

MARCH 2015
BNP Paribas (China) Ltd. granted Type A licence by People's Bank of China (PBoC)

FEBRUARY 2016
PBoC announcement of the new scheme to invest on CIBM

Q1 2017
Offshore investors can hedge their forex exposure linked to their bond positions

JUNE 2017
The settlement cycle can be T+2 for offshore investors, in addition to the existing T+0 and T+1 cycles

JUNE 2018
CIBM Direct investors can hedge RMB fx risk offshore, enjoying onshore RMB exchange rate through offshore RMB participating Banks

NOVEMBER 2018
Three-year income tax and VAT exemption on bonds interest granted to all foreign investors

HONG KONG MUTUAL RECOGNITION OF FUNDS (MRF)

The Mutual Recognition of Funds (MRF) is a bilateral regulatory framework which allows mutual funds of two markets to be distributed to retail investors in each market through a streamlined authorisation process.

ABOUT MRF

A memoranda of understanding (MoU) has been signed between Hong Kong (HK) and 4 European countries: Switzerland, France, the UK and Luxembourg. Through the scheme, fund managers in HK can gain access to a large pool of international investors. Inversely, investors from France, Switzerland, the UK and Luxembourg can increase their exposure to Asian markets. For Swiss, French and Luxembourg asset managers, the MRF complements the UCITs framework.

SCOPE

MRF with Switzerland

The MoU allows a wide variety of Swiss funds to be distributed in HK, including feeder funds, funds of funds, index funds and structured funds.

Various HK fund types are eligible for distribution in Switzerland, with some exceptions namely structured funds that include real estate, commodities or precious metals funds, and those that use strategies based on short selling or investment in derivatives.

MRF with France

HK public funds to be distributed in France are restricted to general equity funds, bond funds and mixed funds. Various eligibility rules apply, including the requirement of a minimum of 20% of the net asset value (NAV) to be attributable to HK investors on an ongoing basis Importantly, funds are considered Alternative Investment Funds (AIFs) and rules applicable to AIF marketing and management apply.

Covered French funds eligible for distribution in HK have similar restrictions in terms of underlying assets, local NAV limits, leverage and hedging arrangements.

MRF with the UK

Eligible HK domiciled funds may be distributed to the UK retail market. Fund types are restricted to regular funds, passive ETFs, index funds and funds of funds investing in equities, bond or mixed funds. Eligible funds may not leverage over 100% of NAV and hedging – except currency hedging – is prohibited.

MRF with Luxembourg

HK Covered Funds are restricted to regular funds with investment in equities, bonds or mixed funds. Leverage above 100% of NAV is prohibited. Commodities exposure is not permitted and a Management company must have a minimum of HKD 10 million in capital.

INDUSTRY IMPLICATIONS

MRF with Switzerland

Foreign collective investment schemes distributed in Switzerland require the asset management company to mandate both a **representative and a paying agent** in the country in fulfilment of its regulatory obligations for both non-qualified and qualified investors. BNP Paribas is licenced as a bank by the Swiss Financial Market Supervisory Authority FINMA so can offer both services.

MRF with France

HK funds marketed in France require one or more correspondents established in France under conditions stipulated by the Autorité des Marchés Financiers (AMF) including a local centralising agent responsible for the collection of subscription and redemption orders, the payment of dividends, and the provision of fund documentation.

MRF with the UK

HK Covered Funds distributing in the UK retail segment need to appoint approved trustees and a custodian under HK jurisdiction, while offering documents must be approved by the SFC with a UK covering document to comply with UK regulation on disclosure.

MRF with Luxembourg

HK Covered Funds must appoint an approved trustee/custodian. Section 16 of the Banking Ordinance states that the trustee/custodian must be a licensed bank, or a subsidiary of such a bank; or a trust company approved by the Mandatory Provident Schemes Authority.

Hong Kong

Fund managers are responsible for product governance covering the entire chain from inception to post sales. They must have a detailed fair valuation policy and procedures in place. Guidance on suspension of dealing as well as disclosures on ongoing charges and past performance, as well as payment of dividends out of capital, must be published.

The role of the **trustee** is particularly crucial. A trustee needs to oversee a range of services including asset safekeeping, verifying NAV calculations, compliance with investment and borrowing limitations, keeping a register of unitholders and issuing an annual report.

BNP Paribas Securities Services' view

- BNP Paribas Securities Services can provide services in these MRF covered markets. For example, in Switzerland BNP Paribas Sercurities Services can act as a fund representative and local paying agent, as well as a contact point for FINMA and monitor of distributors; in Hong Kong through a range of seamless and flexible trustee, fiduciary and fund administration services; in France, as the leading bank in Europe with overall capacity to support cross-border distribution services.

KEY DATES

DECEMBER 2016
MoU signed with Switzerland

JULY 2017
MoU signed with France

OCTOBER 2018
MoU with United Kingdom

JANUARY 2019
MoU with Luxembourg

HONG KONG OPEN-ENDED FUND COMPANY (OFC)

Hong Kong has launched a series of local market infrastructure enhancements to further develop the city as a full-service international asset management centre and a preferred fund domicile. The Securities and Futures Commission (SFC) implemented the Open-ended Fund Company (OFC) structure in July 2018.

ABOUT OFC

The Securities and Futures Commission (SFC) introduced the Open-ended Fund Company (OFC) structure in July 2018. The structure enables investment funds to be established in corporate form in Hong Kong, in addition to the current unit trust form.

The Companies Ordinance prohibits the increase or reduction in capital or payment of dividends without approval of the shareholders of the company, therefore investment funds in Hong Kong usually use a unit trust structure which is more flexible in terms of capital management, however, this unit trust structure requires a trustee that would act for and on behalf of the unit trust. The OFC is established as a legal entity, therefore, is able to act for and on behalf of itself without the need to appoint a trustee. It also allows variable capital structure which is not allowed for a company established under the Companies Ordinance.

Key features of the OFC regulations

An OFC is established and incorporated **under the Securities and Futures Ordinance**. It is not subject to the restrictions of the Companies Ordinance unless otherwise provided in the new OFC Code and rules. For winding-up and disqualification orders, the "Companies (Winding Up and Miscellaneous Provisions) Ordinance" is to be applied to OFCs as well. This approach is to align Hong Kong's legislation for similar corporate fund vehicles with overseas jurisdictions such as the UK and Ireland.

- An OFC must be registered with the SFC and incorporated by the Companies Registry
- OFCs can be public or non-public. A public OFC will have to comply with the detailed requirements as set out in applicable SFC's product handbooks
- An OFC must have a board of directors with at least two individual directors
- An OFC must appoint a custodian to whom all scheme property must be entrusted for safekeeping, a fund manager and an external auditor
- Private OFCs are also eligible for tax exemption under certain conditions

Reference: Code on Open-ended Fund Companies.

SCOPE

- Local and global asset managers

The Hong Kong OFC supports umbrella and sub-funds structures and cross-investment of sub-funds.

INDUSTRY IMPLICATIONS

This OFC regime provides an attractive alternative for funds domiciled in Hong Kong with its flexible features that are currently not available under Companies Ordinance. In addition to encouraging new funds to set up in Hong Kong in competition with other fund domiciles, the new structure should encourage greater fund passporting with Hong Kong as a home country.

Along with the Mutual Recognition of Fund schemes signed between Hong Kong and several jurisdictions including Switzerland, France, the UK and Luxembourg, the OFC framework should facilitate the distribution of Hong Kong-domiciled funds to Europe, with a choice of structure that is internationally recognisable, particularly in Europe.

Passportability of OFC with China is to be confirmed by the SFC.

BNP Paribas Securities Services' view

- The OFC regime increases the competitiveness of Hong Kong-domiciled funds and their marketability across the globe.
- With the launch of similar new company structures in Australia and Singapore however, competition between fund jurisdictions in the Asia-Pacific region is getting more intense. Australia is due to launch its new Corporate Collective Investment Vehicles (CCIV) scheme, and Singapore plans the launch of the Variable Capital Company (VCC) in 2019.
- Fund managers domiciling funds under the OFC in Hong Kong benefit from the territory's long-established fund management industry and its access to China. The profit tax exemption for onshore private Open-ended Fund Companies will be a key driver in the success of the OFC scheme.
- Leveraging its broad expertise in depobank from about eight thousand funds in about ten European countries, BNP Paribas Securities Services has the experience and track record to assist you in Hong Kong in every aspect, from setup, trustee, custody and transfer agency services, to fund administration and portfolio valuation. Services for the OFCs are at a validation stage targeting going live in Q1 2019. In addition, as the leading European bank, with deep and comprehensive cross-border distribution services, we are ideally positioned to support broader international distribution of Hong Kong funds in the region and beyond.

KEY DATES

JUNE 2015
Consultation conclusion

JULY 2017
Proposed legislation to offer profit tax exemption to onshore private OFC

AUGUST 2017
Closing of the formal consultation paper on the OFC code and rules

JULY 2018
OFC goes live

NEW ZEALAND'S KIWISAVER

KiwiSaver is a voluntary work-based savings initiative to encourage New Zealanders to save adequately for their retirement.

ABOUT KIWISAVER

Launched in 2007, KiwiSaver is a voluntary, work-based savings initiative to encourage New Zealanders to save adequately for their retirement, in addition to government superannuation. Nearly 2.9 million New Zealanders have invested approximately USD 35 billion into KiwiSaver (sources: Inland Revenue KiwiSaver membership and Reserve Bank of New Zealand KiwiSaver assets, as at 30 September 2018).

KiwiSaver schemes are registered as managed investment schemes under the Financial Markets Conduct Act 2013, and are established in the form of unit trusts.

REGULATORY FRAMEWORK

Registration

The Financial Markets Authority (FMA) is responsible for registering and regulating KiwiSaver schemes, and oversees licensed managers and supervisors. The main aspects of the regulatory framework are in place:

- The KiwiSaverAct 2006 sets out the major rules around how KiwiSaver schemes operate
- The Financial Markets Conduct Act 2013 introduced a unified regime of governance and reporting for financial products
- Schemes must be registered with the FMA
- A governance framework applies, including prescriptive duties for managers, supervisors and custodians
- A licensing regime applies for some participants including managers. Managers are responsible for issuing KiwiSaver schemes, managing and administering their assets. They may outsource aspects such as unit pricing and fund accounting to service providers. Supervisors (a role equivalent to a trustee) are licensed to hold scheme assets and may appoint custodians, who may in turn appoint sub-custodians
- Product disclosure requirements apply, with a mandatory single Product Disclosure Statement (PDS), Key Information Statement (overview of the offer) and quarterly fund updates (with performance data and risk indicators). Fund documents are posted on the Disclose public website

Tax

New Zealand has a "flow through" tax regime for investment schemes, designed to remove tax disadvantages for low to medium income earners saving through managed funds (previously taxed at 33%), making KiwiSaver an attractive savings scheme.

KiwiSaver schemes are usually Portfolio Investment Entities (PIEs). The unit price of a PIE excludes tax. Instead, the PIE calculates and allocates taxable income and tax credits out to each individual investor, based on the investor's specific tax rate. The PIE is liable for the PIE tax but recovers this from the investors by way of redeeming or issuing units to pay tax/receive a refund. These tax positions are reported to the Inland Revenue on behalf of investors.

INDUSTRY IMPLICATIONS

The Financial Advisers Act 2008 (FAA) is being replaced and will impact KiwiSaver distribution. The new law (likely to be live in 2020) will be technology-neutral, meaning it will not distinguish between human advice and robo-advice (digital tools and platforms). This is intended to allow robo-advice, which the regulator sees as a potentially useful for delivering information and advice on KiwiSaver investments. The regulator has even pre-empted this upcoming legal change by introducing a process in February 2018, whereby providers can be approved to run a robo-advice platform.

The FMA has also updated its guidance on KiwiSaver sales and advice for KiwiSaver providers.

BNP Paribas Securities Services' view

- The general direction of regulatory change is to encourage more New Zealanders to consider investing in KiwiSaver and increase transparency for investors. Our view is that KiwiSaver will continue to be the mainstay of the New Zealand retail funds environment, and that there will be increasing levels of public interest in KiwiSaver as account balances grow.
- We expect that legal changes will encourage banks and other providers to develop online software and technology to provide easy-to-use, low-touch access to advice on KiwiSaver investments. Robo-advice platforms therefore look like being a key mechanism for advice and information on KiwiSaver, although it is unlikely that robo-advice will completely replace human intervention.
- There is continuing public debate as to how managers of KiwiSaver schemes take into account environmental, social and governance (ESG) factors. Many local fund managers have previously aligned their strategies with the approach taken by New Zealand's sovereign wealth fund, which has screened out of their portfolio specific investments and sectors. However we expect that managers will start to use third party technology, or to build proprietary systems, to develop their own bespoke ethical investment strategies for KiwiSaver money.

KEY DATES

2007
KiwiSaver framework introduced Tax transparent PIE regime introduced

DECEMBER 2016
New FMCA regime fully implemented

FEBRUARY 2018
Introduction of exemption to enable personalised robo-advice

2020
New Financial Advisers legislation likely to be introduced simplifying the regulatory framework for financial advice and encouraging New Zealanders to seek advice on KiwiSaver

SINGAPORE VARIABLE CAPITAL COMPANY (VCC)

Previously known as "S-VACC", the Singapore Variable Capital Company (VCC) aims to promote fund domiciliation in Singapore and position the city as an attractive investment hub for the Asia-Pacific region. We expect it to be launched in 2019.

ABOUT VCC

In 2016, the Monetary Authority of Singapore (MAS) announced its intention to launch an open-ended investment company scheme to position Singapore as an attractive investment hub for the Asia-Pacific region. VCC is a company-type fund structure which is expected to be launched in 2019.

Under the current regulations, funds in Singapore can be established in the form of unit trusts, companies (fixed capital) and as limited partnerships. Unit trusts are commonly used for retail and restricted funds, and require the appointment of a trustee to act for and on behalf of each fund. Companies (fixed capital) and limited partnerships are non-unit trust type funds mainly used for funds for alternative assets.

The MAS has set an objective to boost the asset management industry and promote fund domiciliation in Singapore and identified the need to create a company type fund with a variable capital structure. It will be the fourth fund type in Singapore, and aims to provide flexible and comprehensive coverage to address the limitations of the existing schemes.

The Singapore Variable Capital Company:

- Covers both traditional and alternative assets
- Can be open-ended and closed-ended
- Supports umbrella and sub-fund structures
- Can be used for both retail and non-retail strategies
- Is governed by VCC Act
- Has access to 80+ tax treaties

In October 2018, MAS announced the further details about VCC tax framework following their initial announcement in February 2018. Key extracts are the following:

- A VCC will be treated as a company and a single legal entity for tax purposes
- VCCs that are Singapore tax residents are eligible to access Singapore's tax treaties. In case of umbrella VCCs, the sub fund names as well as the umbrella fund name will be included in the Certificate of Residences
- The tax incentive schemes for funds under sections 13R and 13X of the Income Tax Act (ITA) are extended to VCCs
- 10% concessionary tax rate under the Financial Sector Incentive-Fund Manager (FSI-FM) scheme will be extended to approved fund managers managing an incentivised VCC

SCOPE

The Singapore VCC structure is intended for global asset managers who seek to establish funds in Singapore and raise investor capital from the Asia-Pacific region. According to the 2017 Singapore Asset Management Survey published by the MAS, Singapore's total assets under management was USD 79.2 trillion, of which 78% was sourced from outside Singapore.

INDUSTRY IMPLICATIONS

The VCC fund scheme is expected to encourage funds passporting with Singapore as a home country. This scheme will further promote Singapore as an attractive centre for both investment fund domiciliation and fund management activities.

BNP Paribas Securities Services' view

- This new Singaporean fund scheme is part of a wider plan to foster cross-border fund distribution from Singapore to the rest of the Asia-Pacific region. Whilst the introduction of the VCC is an important step towards the government's aims to become a centre for regional asset managers, the fund promoters will analyse the costs and the benefits of VCCs and of other fund schemes to select the best scheme that suits their objectives.
- Singapore is currently a member of the ASEAN Collective Investment Scheme (CIS) with Malaysia and Thailand. It is also in discussions with China on a future mutual recognition of funds scheme. And, the Singapore government is still considering joining the new Asia Region Funds Passport (ARFP) which is expected to be launched in early 2019 by the five current participants including Australia, Japan, Korea, New Zealand and Thailand.
- The Singapore Variable Capital Company will provide an alternative to the existing fund structures together with the region's other company type funds such as Hong Kong's Open-Ended Fund Company (OFC) and Australia's Corporate Collective Investment Vehicle (CCIV).
- The Asia-Pacific region is characterised by a web of varied local regulations and different schemes to enable fund managers to invest cross border. However, thanks to a direct local presence across the region, BNP Paribas Securities Services and its team with extensive cross border experience are able to guide our clients on the various passport schemes and fund schemes including the ASEAN CIS, the Asia Region Fund Passport, the mutual recognition schemes, and the new VCC scheme.

KEY DATES

24 APRIL 2017
Public Consultation closed

19 FEBRUARY 2018
Tax framework for VCC announced

31 OCTOBER 2018
Further details on the tax framework for VCCs released

Q2 2019
Second Consultation on VCC

Q3/Q4 2019
Subsidiary regulations to be announced

Q4 2019
VCC goes live

REGULATIONS IN THE UNITED STATES

FINRA RULE 4210

In the United States, the agency mortgage-backed securities (MBS) market is the second largest after US treasuries, representing an average total par value of USD 4.5-5 trillion (source: FINRA TRACE report). 90% of the agency MBS market consists of TBA (to-be-announced) forward-settling transactions, with a significant portion being executed on a bilateral basis and not cleared through a CCP.

ABOUT FINRA RULE 4210

FINRA Rule 4210 is designed to enforce application of margin requirements (mark-to-market and maintenance margin) to covered agency transactions (bilateral forward-settling transactions in agency MBS), issued in conformity with a program of an agency or Government-Sponsored Enterprise, such as Fannie Mae, Ginnie Mae or Freddie Mac. This regulation pursues the following objectives:

- Reduce exposure to counterparty default risk through collateralization process implementation
- Promote a harmonized margin requirements framework
- Establish monitoring of outstanding mark-to-market deficiency (uncollected margin)
- Address systemic risk concerns

SCOPE

Eligible transactions

- To-be-announced (TBAs), adjustable rate mortgages (ARMs) and specified pools having contractual settlement at least one business day after trade date
- Collateralized mortgage obligations (CMOs) having contractual settlement date at least three business day after trade date
- Executed on a bilateral basis between a counterparty* and a broker/dealer regulated by FINRA, not cleared through a registered clearing agency and having a gross open position greater than USD 10 million (per counterparty)

Margin requirements (unless exceptions)

- Mark-to-market (variation margin) counterparty's loss resulted from marking eligible transactions to the market (position valuation)
- Maintenance margin (initial margin) – 2% contract value of net long or net short position, by CUSIP per counterparty
- Margin may not be exchanged if mark-to-market loss does not exceed a minimum transfer amount (MTA of USD 250,000) aggregated per single counterparty
- Some counterparties (certain mortgage banks, federal banking agencies, central banks or sovereign government bodies) or assets (multifamily housing securities or project loan program securities) are exempt from margin requirements as long as the dealer's credit risk department enforces due diligence on the counterparty

INDUSTRY IMPLICATIONS

FINRA Rule 4210 is a step toward market integrity and avoidance of systemic event. Reducing overall exposure to credit risk and implementing best practices are key objectives for the industry as whole.

Nevertheless, financial actors may also face roll-out challenges. Finding a right balance between overall benefits and cost of regulation implementation is not always easy.

Late modifications in the blueprints affect an actor's capacity to deliver a full automated solution in a timely manner and create additional operational dependencies. Further, because of the overlap of several ongoing compliance initiatives and deadlines, there is concern of "bottle-neck" situations on legal documentation and KYC framework processing.

BNP Paribas Securities Services' view

- We believe that the introduction of margin requirements on uncleared transactions and expansion of collateralization technique are key tools to mitigate risks. This initiative contributes to overall market health and transparency.
- We welcome the proposal to repeal maintenance margin as a step forward in simplifying regulation. However, we think that regulators should address the evolving framework in an efficient manner.

For the full memo please visit our website

KEY DATES

DECEMBER 2016
Phase 1, FINRA members to enforce written risk limit determination procedure (credit risk due diligence)

JANUARY 2019
FINRA filled for effective date postponement. Yet, they are still to provide feedback and comments on content alterations

MARCH 2020
FINRA 4210 regulation target go-live date

* Any counterparty, buy-side or sell-side (non-broker) participant, entering into buy/sell transactions (on these assets) with a FINRA member. A FINRA member is a US regulated broker/dealer.

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