Welcome

Welcome to the 2017/2018 Edition of the Global Regulatory Update. This guide is designed to provide corporate clients with an insight into the current state of play of key developments around the globe.

Regulatory reform at all levels of the financial services spectrum has continued over the last year. Combined with the challenge of diverging timelines when it comes to implementation, many measures are also likely to differ in their detailed approach, which has the potential to create further challenges for the financial services industry and their services to corporates.

New developments in Financial Technology (FinTech) provide firms with the opportunity to offer innovative services to clients and are added to the list of issues regulators are turning their attention to. Our team is heavily engaged with regulators and industry participants around the world to understand the opportunities and implications of FinTech and to pave the way for new business models and appropriate regulatory measures in this space.

Having provided you with this high-level outline of relevant measures, we would be happy to talk to you on any areas of interest.

We hope you find this guide useful and look forward to discussing it further.

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# Contents

**PART I: Issues affecting the banking industry and the broader market**

1) **Financial Technology, the intersection of regulation and innovation**

2) **Capital, liquidity, leverage**
   a) The Basel framework: next steps towards Basel
   b) Basel III in Europe
   c) Basel III in U.S.

3) **Bank Structural Reforms and Recovery & Resolution**
   a) EU Bank Structure Reform (BSR) Regulation
   b) EU Bank Recovery & Resolution Directive (BRRD)
   c) U.S. Volcker Rule

4) **Taxation measures:**
   a) OECD BEPS
   b) Common Reporting Standard (CRS)

**PART II: Regional regulatory and market changes**

**EMEA**

1) **UK Brexit**

2) **Payments**
   a) The Single Euro Payments Area (SEPA) & Instant Payments
   b) The European Payment Services Directive II (PSD)
3) Securities custody, clearing and processing  36  
a) European CSD legislation (CSDR)  36  
b) European Post Trade Reforms  40  

4) Securities infrastructure  42  
a) European Market Infrastructure Regulation (EMIR)  42  

5) The investment industry  45  
a) The European Markets in Financial Instruments Directive (MiFID) II  45  
b) European Regulation on Money Market Funds  46  

6) Funds and fiduciaries  48  
a) The European Alternative Investment Fund Managers Directive (AIFMD)  48  

7) The General Data Protection Regulation  53  

U.S.  54  

1) Dodd-Frank Wall Street Reform and Consumer Protection Act  54  

2) Securities infrastructure  58  
a) Derivatives Reforms: U.S.-EU Equivalence  58  

3) Taxation  60  
a) IRS Section 385  60
LATIN AMERICA  

1) Argentina  
   a) Economic & Financial Adjustments  
   b) Capital Markets Reform and Tax Reform  
   c) Anti-Money Laundering / Combatting Terrorist Financing Reform 

2) Brazil  
   a) Economic Reform Agenda  
   b) Financial System Reform 

3) Chile  
   a) Banking Modernisation Bill  
   b) Pension Reform 

4) Colombia  
   a) Financial Conglomerates Law 

5) Data Privacy across Latin America 

6) Cybersecurity across Latin America 

ASIA  

1) China RMB internationalisation 

2) RRP: Asia Developments 

3) Data On-shoring across Asia
1) Financial Technology (FinTech): the intersection between innovation and regulation

The term ‘FinTech’ has hit the financial services industry by storm over the last 3 years and has become the latest buzzword to be used by regulators, the ‘regulatees’ (regulated financial services firms) and unregulated firms.

When thinking about ‘FinTech’ the most logical starting point is to define the term. The term remains undefined in law. Rather, regulatory bodies and authorities have described it in different ways. A commonly referenced definition is the one provided by the Financial Stability Board (FSB): “technologically enabled financial innovation that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services” and can be found here http://www.fsb.org/what-we-do/policy-development/additional-policy-areas/monitoring-of-fintech.

Now that we are armed with a description of the term it is easy to see why regulators are so excited about FinTech. It enters their regulatory perimeter because finance is a regulated industry. It therefore follows that the delivery of regulated activities through the use of technology enters their remit. On the flip side it is also very easy to understand why regulated (and unregulated) firms are also excited about FinTech. Through the use of financial technology financial firms can offer better, cheaper and new services to their clients and technology firms entering the financial services market can transform the market place causing traditional financial services firms to rethink their business models and services so as to not become disintermediated.

So what are some of the main regulatory FinTech initiatives have we observed over the last year?

At a global level the FSB is actively monitoring and assessing FinTech developments (given its mandate to promote financial stability) with a view to identifying supervisory and regulatory issues that merit authorities’ attention. Their latest report (dated
27 June 2017) identifies 10 areas, of which the following 3 are seen as priorities for international collaboration:

- the need to manage operational risk from third-party service providers;

- mitigating cyber risks; and

- monitoring macro-financial risks that could emerge as FinTech activities increase.

The FSB says that addressing these priority areas is seen as essential to supporting authorities’ efforts to safeguard financial stability while fostering more inclusive and sustainable finance.

At a European level the European Banking Authority (EBA) published a Discussion Paper on their approach to FinTech in August 2017 and the European Commission published a Consultation Paper on FinTech in March 2017. We are engaging in these policy discussions so that any future ‘FinTech’ regulatory framework will allow us to continue to innovate for our clients and will maintain a level playing field between incumbents and start-ups. Also at a European level, the European Parliament is working on a Blockchain communication, to be published by year end. We are closely engaged with the leading MEP.

We have also observed regulators across the globe set up ‘Innovation Hubs’ as a way of encouraging the introduction of innovative financial products to the market. It is in this context that we have seen numerous regulators globally introduce / planning to introduce so called regulatory sandboxes. These are regulator driven initiatives which allow firms to test innovative products / services in a live environment under the regulator’s supervision and without incurring the entire regulatory burden during the testing period. The UK regulator, the Financial Conduct Authority (FCA) was the first regulator to set up a sandbox and is the most advanced in the sandbox timeline and in its thinking with a clear established process, eligibility and lessons learnt from the first sandbox cohort. Many regulators around the world have followed in the FCA’s footsteps and have created / are planning to create similar sandboxes and there is talk in Europe about creating EU-wide sandboxes for cross boarder innovation. It is an area we are actively involved in not only to ensure sandbox consistency but also to see how we can use sandboxes to progress our own innovation agenda.

We have seen some limited regulation in relation to distributed ledger technology (DLT- the technology underpinning Bitcoin and other cryptocurrencies). The state of Delaware for example has passed amendments to state law that make explicit
the right to trade stocks on a blockchain, according to multiple sources familiar with the matter. The measures were part of a broader series of amendments that legally recognized any number of records being stored on a blockchain.

So what are some of the innovative solutions Citi has brought to market?

• On 28 February 2017 Treasury and Trade Solutions launched an Application Programming Interface (API) solution for payment initiation, payment status, and account balance inquiries through CitiConnect®, our connectivity platform. The CitiConnect® API allows our clients to directly connect with Citi to access services using their own Treasury Workstations or Enterprise Resource Platform (ERP) providing convenience, potential cost savings, and reduced risk. The result is a seamless experience that has the potential to offer cost efficiencies and reduced operational risk. APIs make it simpler for our institutional clients to develop interfaces to Citi to access and manage their accounts allowing for Citi to offer a variety of transaction services in a dramatically different way. Following this initial launch, we expect to continue to develop additional API services for transaction banking including service inquiries, account management, and liquidity services. We support API based integration across 96 countries, representing one of the largest API-supported geographies.

• On 22 May 2017 Treasury and Trade Solutions alongside NASDAQ announced a new integrated payment solution that enables straight through payment processing and automates reconciliation by using a distributed ledger to record and transmit payment instructions. A number of payment transactions have been concluded, including Citi's automated processing of cross-border payments via a link between the CitiConnect® for Blockchain connectivity platform and the Linq Platform powered by the Nasdaq Financial Framework. This collaboration has created a pioneering institutional banking solution that tightly integrates blockchain technology with Citi's global financial network leveraging API technology. The partnership between Citi and NASDAQ leverages Chain's blockchain infrastructure platform and draws on core competencies from industry leaders who are at the forefront of innovation in the global financial sector. Emerging technologies like Distributed Ledger Technology (“DLT”) are driving digitization and enabling new platforms and blockchain ecosystems that can provide real-time digital solutions. For example, this integration can allow businesses such as Nasdaq Private Market to address the challenges of liquidity in private securities by streamlining payment transactions between multiple parties.
The Regulatory and Market Strategy team continues to take a very active role in influencing regulators, policymakers and central banks so that the topic of FinTech is addressed in a way that will enable us to continue to innovate for our clients. We hold a range of positions at industry bodies looking at the topic of FinTech, we have direct 1:1 dialogue with policymakers, we respond to the various consultation papers and we are regular presenters at conferences as a way of sharing our view and shaping the landscape. We have held a range of events this year to share our thoughts and innovation capabilities with you (for example our Cash Management Innovation Forum in London 13 June 2017) and we look forward to continuing our dialogue with you.

2) Capital and liquidity

a) The Basel framework: next steps towards Basel IV

A summary of the issues and current status

The Basel Committee on Banking Supervision (BCBS) continues its journey towards Basel IV. The last edition of this guide covered in detail the various regulatory developments at BCBS level that capture Basel IV. In particular we highlighted the move towards a tougher stance on internal model based calculations of capital requirements. The BCBS has been working on the implementation of revised standardised approaches, capital floor, and other constraints on the use of internal models:

- **Standardised Approach** for Measuring Counterparty Credit Risk Exposures (SA-CCR) for derivatives, which will include different calculations for individual asset classes and rules regarding the treatment of particular product sets;

- **Fundamental Review of the Trading Book (FRTB)** targeted at market risk, impacting all institutions, even those using the internal ratings based approach (IRB). Banks will need more data points to be able to perform the required calculations, e.g. to calculate deltas and vegas (volatility) for prescribed risk factors and then feed these into the standardised FRTB calculations. These data attributes have historically only been required for options, but will now also be needed for other product types.

So where do we stand with these developments? The standardised approach for measuring counterparty credit risk exposures for derivatives remains unfinished. Progress has been made on the FRTB since the BCBS published the final standard in January 2016. Firms are working towards implementation and we have clarity on the implementation deadlines. The BCBS has called for the adoption of FRTB by each jurisdiction by January 2019 and for compliance to begin by December 2019.
IT systems: Bank’s risk data aggregation capabilities have been a source of concerns for the BCBS. The crisis showed that IT systems failed to support the management of financial risks. Banks couldn’t properly measure risk exposures and identify concentrations quickly and accurately. In 2013 the BCBS published Principles for effective risk data aggregation and risk reporting. The BCBS has now turned its attention to the implementation of these principles and published a progress report on 27 March 2017. It notes that while some progress has been made, most G-SIBs have not fully implemented the Principles and the level of compliance with the Principles is unsatisfactory. In view of the results and to promote further adoption of the Principles, the Basel Committee has made the following additional recommendations:

- Banks should develop clear roadmaps to achieve full compliance with the Principles and to comply with them on an ongoing basis.
- Supervisors should: (i) communicate the assessment results to their banks and provide the necessary incentives to achieve full compliance with the Principles; and (ii) continue to refine their techniques to assess banks’ compliance with the Principles.

Leverage ratio above the 3% Basel III minimum. The BCBS is looking into calibration of minimum leverage ratio and definition of the capital numerator. On 6 April 2016 the BCBS issued a consultative document entitled: Revisions to the Basel III leverage ratio framework, and responses to a third set of frequently asked questions (FAQs). This document was re-published on the 25th of April due to a number of errors found in the previous document. The consultation period closed on 6 July 2016. We were aware for some time that the BCBS would propose a further tightening of the leverage ratio (any increases would have an impact on banks’ cost of capital) and the BCBS had planned to finalize this updated framework by end of 2016 as part of its regulatory reform program, however this has not yet happened.

The proposed revisions cover the following issues:

- To measure derivative exposures, the Committee is proposing to use a modified version of the standardised approach for measuring counterparty credit risk exposures (SA-CCR) instead of the Current Exposure Method (CEM) as mentioned above;
- To ensure consistency across accounting standards, two options are proposed for the treatment of regular-way purchases and sales of financial assets;
• Clarification of the treatment of provisions and prudential valuation adjustments for less liquid positions, so as to avoid double-counting; and

• Alignment of the credit conversion factors for off-balance sheet items with those proposed for the standardised approach to credit risk under the risk-based framework.

The BCBS is also seeking comment on an additional leverage ratio requirement applicable to global systemically important banks. Before finalizing design and calibration of the leverage ratio the BCBS will also take into account the forthcoming comprehensive quantitative impact study. The BCBS also plans to incorporate the final revised framework of the Standardised Approach for credit risk into the leverage ratio regime in the future. However, until those revised credit conversion factors (CCFs) are implemented in the standardised approach for risk-based capital ratio purposes, the corresponding CCFs that currently apply in the Basel III leverage ratio framework will remain in effect. In terms of cash pooling the BCBS proposes a more detailed and restrictive interpretation of the leverage ratio as follows:

• Notional (or virtual) cash pooling combines the balances of several accounts of the entities within a corporate group in order to limit low balance or transaction fees without physical transfer of funds. Instead, balances of different entities are set off within the group, so that a bank charges interest on the group's net cash balance. The Committee proposes that these balances be reported on a gross basis in line with revisions to paragraph 13 (paragraph 11 as revised) of the Basel III leverage ratio framework, which does not allow netting of assets and liabilities nor the recognition of credit risk mitigation techniques.

• Physical cash pooling, which combines various accounts from entities within a corporate group into a single master or concentration account at the end of each period through physical transfer of funds, typically by means of intraday settlement. The Committee proposes to allow banks to report those balances on a net basis if the transfer of credit and debit balances into a single account results in the balances being extinguished and transformed into a single balance (i.e. a single claim on or a single liability to a single legal entity on the basis of a single account) and the bank cannot be held liable in case of non-performance of one or multiple participants in the cash pool. The proposal also requires such settlement to take place at least on a daily basis in order to be recognised on a net basis for the Basel III leverage ratio exposure measure.

Next steps: Following the comment period the BCBS will work on a revised framework with the aim to publish final rules which we are still awaiting.
For more information please refer to the underling consultation https://www.bis.org/bcbs/publ/d365.pdf and FAQs https://www.bis.org/bcbs/publ/d364.pdf

Citi continues to be closely involved in working with regulators and market bodies at global, European, UK and U.S. levels as the implications of all these proposals continue to be debated, refined and understood. We are also investing considerable time in keeping our clients informed about these forthcoming changes and the potential implications they may have.

Implications for banks and their clients
The revised capital requirements are starting to impact access to credit for small and medium-sized companies (exacerbated by the move towards a standardised approach to risk measurement), whilst larger corporates working with the major banks are less impacted due to their own more stable capital and liquidity positions.

For banks, the move towards a standardised approach (a ‘one size fits all’ model) is a more crude way of risk categorisation, which does not allow banks to consider the risks specific to their businesses.

This one size fits all model will have make it more difficult for banks’ lending to SME’s, i.e. non-rated companies, as banks need to take on 100% risk. So there is an economic concern that these entities counterparties will have less access to financing, including trade finance.

b) Basel III in Europe
A summary of the issue and current status
Basel III is considerably advanced in Europe. The capital requirement directive (CRD IV) and regulation (CRR I) were adopted in 2013 and apply since the beginning of 2014. The European Banking Authority (EBA), the pan-European prudential supervisor, has played a critical role in defining technical standards that support the implementation of the European Basel regime. We also provided details on CRD IV along with a comparative analysis on how the EU rules differ from Basel III and how this leads to a fragmented regulatory landscape in our last guide.

Preparation of the CRD IV review - what lies ahead for Europe?
We indicated at the last edition of this guide that we were anticipating a European Commission legislative proposal amending CRD IV/CRR I to complete the Basel III agenda. During the course of November 2016 the European Commission published
a range of legislative proposals to further strengthen the resilience of the EU banking sector:

- A Directive to amend CRD 4 (covered immediately below); and
- Two Directives to amend the Bank Recovery and Resolution Directive (BRRD) - covered in a separate section in this guide and a Regulation to amend the Single Resolution Mechanism Regulation (SRMR).

The CRD 4 amendments include proposals on some of the key Basel III metrics in particular the leverage ratio (LR), requirements for the net stable funding ratio (NSFR) and the fundamental review of the trading book (FRTB) to ensure that banks hold sufficient capital in line with the effective risks they take when trading in securities and derivatives. The measures are also intended to make capital requirements more proportionate for smaller and less complex institutions, in relation to disclosure, reporting and trading book-related requirements. It should be noted that the proposals do not include a leverage ratio buffer for global systemically important banks (G-SIBs) as international discussions are still ongoing on this issue. In relation to the proposals on the NSFR these are largely in line with the Basel standard with some adjustments recommended by the European Banking Authority in order to ensure that the NSFR does not hinder the financing of the European real economy. Similarly regarding the review of the FRTB the European Commission has adhered to the main Basel standard (adopted in January 2016) with some targeted measures for EU implementation:

- Reflecting some EU specificities, such as simple, transparent and standardised (STS) securitisations, covered bonds and the treatment of sovereign exposures to ensure the consistency of our regulatory framework and support the objectives of the Capital Markets Union (CMU); and
- Phasing-in the overall level of the requirement, to prevent a disproportionate immediate impact on banks’ capital requirements.

The Commission is also proposing for third-country banking entities operating with two or more institutions in the EU and which have total EU assets of more than EUR30bil, or which are part of a Globally Significant Institution, to establish an EU-located intermediated parent undertaking (IPU). At the time of writing it is unclear if this provision will make it through the legislative process and it is subject to heavy industry lobbying as the proposal conflicts with third country’s legal frameworks (particularly U.S. banking law) for bank structures.

**Implications for banks and their clients**
The comprehensive revision of European prudential rules under CRD IV was challenging to implement for banks in Europe as well as foreign bank subsidiaries located in the EU.

In the context of the banking stress brought about by the Euro crisis, raising capital was and continues to be difficult for some players, often accompanied by a deleveraging of the balance sheet.

c) **Basel III in the U.S.**
In the meantime, the U.S. has also been progressing on Basel III. So far the three ‘Agencies’, the Federal Reserve (FED) Board, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) have approved the U.S. capital regime, the leverage ratio, the LCR liquidity rules and the G-SIB capital surcharge.

A key departure from the original Basel III proposal is the fact that the U.S. will apply the regime to all U.S. banking organisations except small bank holding companies (BHCs) and non-covered savings and loan holding companies (SLHCs), rather than only the internationally active banks.

Another area of general difference to Basel III is the inability for U.S. banks to use external credit rating agencies. Instead the U.S. Basel III approach encourages use of non-ratings based alternatives.

By way of reminder in the last Global Regulatory Update 2015/2016 we covered the U.S. Basel III final rule in relation to capital, the leverage ratio and the LCR liquidity regime. So what progress has been made since last year?

**Net Stable Funding Ratio (NSFR)**
On June 1, 2016, the OCC, the FDIC and Board of Governors of the Federal Reserve System published the much-awaited proposed rule to implement the Net Stable Funding Ratio (the NSFR). The proposal would require large U.S. banking organizations
to maintain what the Agencies have determined to be a stable funding profile over a one-year horizon. Comments on the proposed rule were due by August 5, 2016. The proposed rule comes approximately one and a half years after the BCBS finalized its version of the NSFR in October 2014. The Agencies intend the NSFR to complement the Liquidity Coverage Ratio (LCR), finalized by the Agencies on September 3, 2014 and covered in the 2014/2015 edition of our Global Regulatory Update. While the LCR aims to promote short-term liquidity resilience by requiring affected banking organizations to hold a minimum amount of high-quality liquid assets (HQLA) to fund their liquidity needs over a 30-day horizon, the NSFR is designed to reduce funding risk over a one-year horizon.

Both the LCR and NSFR address perceived risks arising from excessive dependence on unstable short-term funding. To mitigate these perceived risks, the LCR and NSFR impose quantitative funding requirements on banking organizations, thereby seeking to ensure that banking organizations have sufficient cash and cash equivalents to operate during times of significant stress and market dislocation.

Points for comparison:
Although the proposed rule is largely consistent with the Basel Committee’s NSFR, it departs from the Basel NSFR in several key respects—a few of which are captured below:

- **Scope**: The Basel NSFR expressly applies to “internationally active” banks on a consolidated basis, but gives national regulators the discretion to tailor the scope of applicability. The Agencies have interpreted “internationally active banks” to include banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in total on-balance sheet foreign exposure.

- **Available Stable Funding (numerator)**: Unlike the Basel NSFR, the U.S. NSFR explicitly includes various types of brokered deposits. This inclusion of brokered deposits by the Agencies appears to be an effort to synchronize the LCR with the NSFR.

- **Disclosures**: The U.S. NSFR would require disclosure of certain ASF categories that are not separately broken out under the Basel NSFR. The disclose template in the U.S. is also different to the Basel as it requires disclosure of additional components that comprise the ASF and required stable funding (RSF) calculations.

In terms of next steps like the Basel NSFR, the U.S. NSFR would have an effective date of January 1, 2018.
Total Loss Absorbing Capacity Requirement (TLAC)

The TLAC requirement is part of the series of measures set by global regulatory authorities following the financial crisis to address the perception that certain firms are ‘too big to fail’. Hence, the development of TLAC in the U.S is on the back of proposals set at global level by the Financial Stability Board (FSB). In the last edition of this guide we covered how TLAC is being implemented in the U.S and its key provisions (enshrined in the consultation paper issued by the U.S. Federal Reserve Board (FRB)). Many banks responded to the FRB’s consultation paper. It is also interesting to consider some of the comments made by the Federal Deposit Insurance Corporation (FDIC- the U.S. deposit insurance entity) in reaction to TLAC. In a speech made on 9 November 2016 the FDIC’s Vice Chairman, Thomas M Hoenig explained that whilst the goals of TLAC are laudable there are problems with the detail: added long-term debt requirement places earnings demands on the banking system and could be counterproductive, especially during a period of financial stress. He also says that it is paradoxical to suggest that the best way to manage the effects of excess leverage and financial vulnerability is to layer on even more leverage, potentially raising financial vulnerability. Furthermore, he says that TLAC has other destabilizing features. Because it is debt, buyers can—and often do—get insurance on potential default through the CDS market. This increases the level of interconnectedness in the financial system and amplifies the risk of contagion. The acceptance of TLAC as a capital replacement is untested, and there is no assurance that the level of debt required would be sufficient to avoid panic by both the debt and equity holders during a time of financial stress.

Since our last guide the FRB has finalised the TLAC rules. On 15 December 2016 the FRB voted unanimously to adopt the final rule.

Like the proposal issued in October 2015 (which we covered in our previous guide), the final rule will set a minimum level of long-term debt for domestic GSIBs and the U.S. operations of foreign GSIBs that could be used to recapitalize the critical operations of the firms upon failure. The complementary TLAC requirement will set a new minimum level of total loss-absorbing capacity, which can be met with both regulatory capital and long-term debt. These requirements will improve the prospects for the orderly resolution of a failed GSIB and will strengthen the resiliency of all GSIBs.

The final rule also will require the parent holding company of a domestic GSIB to avoid entering into certain financial arrangements that would create obstacles to an orderly resolution. These “clean holding company” requirements will include bans on issuance of short-term debt to external investors and on entering into derivatives and certain other types of financial contracts with external counterparties.
In response to comments received on the proposed rule, the FRB made several notable changes:

- The final rule will grandfather long-term debt issued on or before December 31, 2016, by allowing it to count toward a firm’s long-term debt requirement even if the debt has certain contractual clauses not allowed by the rule. To count toward a firm’s long-term debt requirements, debt issued after that date will need to fully comply with the rule;

- While foreign firms’ U.S. operations will generally be required to issue long-term debt to their foreign parent, the U.S. operations of certain foreign firms will be permitted to issue long-term debt to external parties, rather than solely to their parent companies, consistent with their resolution strategy; and

- The long-term debt requirements of foreign firms were slightly reduced to be consistent with the treatment of domestic firms, reflecting the expectation that the losses of those firms would slightly reduce their balance sheets and the capital needed for recapitalization.

Next steps: All firms will be required to comply with the rule by January 1, 2019.

**Implications for banks and their clients**

Based on current funding profiles it is unlikely that most U.S. banks will face a significant challenge in meeting the NSFR’s quantitative requirements by January 2018. The more challenging part of the NSFR is that it introduces yet another metric that banks need to monitor and measure and balance against constraints enshrined in other regulatory requirements. It will be interesting to see how the current small available stable funding shortfall is impacted in the future if interest rates rise as higher quality available stable funding such as deposits will likely flow out of banks and towards other asset classes (such as money market funds - whose yields will rise more immediately). While rates have not risen much (yet) we have not seen this happen, primarily due to the money market funds reforms which went live in October 2016 (and which were covered in the last edition of this guide) which resulted in a shift of assets out of prime funds into bank deposits and government funds.

Further, the introduction of the NSFR to complement the short-term time horizon metric, namely the Liquidity Coverage Ratio (LCR), will impact those banks, which restructured any products / service to avoid LCR related costs.

Certain features of TLAC debt such as restrictions on holdings by other GSIBs will limit the scope of the investor base and may lead to an increase in funding costs for banks.
The challenges of meeting the TLAC standard will mainly be felt by large retail banks where retail deposits are the key component of their funding model. These banks have little long-term debt outstanding and so will need to increase their issuance. Adding new long-term debt will push up these banks’ funding costs given the higher cost of long-term debt relative to deposit funding. Apart from retail only banks, universal banks will also have to raise TLAC based on their type of funding model. Investment banking GSIBs that rely on short term and long term funding are expected to only feel a marginal increase in funding costs.

3) Bank Structural Reforms and Recovery & Resolution

a) EU Bank Structure Reform (BSR) Regulation

A summary of the issue and current status

The European Commission published a draft Regulation on BSR on 29 January 2014. This follows a report from the Liikanen group (October 2012), which recommended mandatory separation of proprietary trading activities from deposit-taking banks. The BSR Regulation goes further, suggesting a ban on proprietary trading and aims to address the largest and most complex banks which are ‘too big to fail, too big to save and too complex to resolve’. It should be noted that the current scope of the BSR Regulation, including scope (de minimis thresholds etc.), the prohibition on proprietary trading and any potential separation requirements are not in final form and agreement has not as yet been reached between the EU institutions. The below is based upon the European Commission proposals.

Main elements of the draft Regulation:

- Ban on proprietary trading. A ban on proprietary trading if for the ‘sole purpose’ of making a profit for own account without any connection to client activity or hedging the entity’s risk, through the use of specifically dedicated desks, units, divisions or individual traders. Also a ban on investing in AIFs and holding any units or shares of an entity engaging in proprietary trading/investing in AIFs.

- Potential separation of certain trading activities. The BSR Regulation requires separation of a bank’s trading activities where certain metrics are met (metrics currently based on size not risk) and may require separation of trading activities where the activities pose a threat to the bank’s financial stability or the EU financial system. The extent of separation, in accordance with the prescribed metrics, is to be determined by national authorities. Upon separation of such trading activities,
the ‘ring fenced’ entity will only be allowed to trade certain cleared derivatives both for hedging its own risks and for client hedging services (the scope of this potential ‘hedging exemption’ is still unclear).

Scope:

The European Commission estimated that out of some 8,000 banks operating in Europe, only 30 would be affected by the proposal, but that these 30 would account for around 65% of total EU banking assets.

Coverage under the draft BSR Regulation:

• EU banks that are deemed to be a global systemically important institution (G-SIIs) under the CRD IV Directive;

• EU banks that for a period of three consecutive years have (i) total assets amounting to at least €30 billion and (ii) trading activities amounting to at least €70 billion or 10 per cent of their total assets (please note that these thresholds are subject to debate in ongoing trilogues and may be subject to significant changes in the final text):

  ✤ Subject to 3rd country equivalence exemption BUT no equivalence where no reciprocity (so currently U.S. regime would not be equivalent). Equivalence will be determined by the European Commission.

Implications and discussion points

In the context of the BSR Regulation it is worthwhile to recall that significant amounts of work are already being undertaken to address the safety and soundness of large and complex financial institutions, in particular with the Bank Recovery and Resolution Directive as well as the European Basel III implementation under CRD4. At this stage there are various reforms at European level, where many of these are still in the implementation stage, the cumulative impact of which has not been considered thus far. One area of focus that should be considered is the potential impact of structural reform on financial stability versus the costs to the real economy.

Another area to consider is the impact on third countries vis-a-vie Europe. For example it is currently not clear how the European legislation would impact EU operations of third country firms. In particular, there needs to be clarity around the treatment of branches of non-EU firms and how separation would work in this case. In the same vein there is a question around the interaction of EU rules with laws in other
jurisdictions, such as the Volcker rule and U.S. banking regulations. There could be potential overlaps or conflicts and it is currently not clear to what extent the Financial Stability Board’s recommendations ahead of the Brisbane G20 meeting, which advocated for “widespread adoption of flexible outcomes-based approaches to resolving cross-border market regulation issues” are being embraced in practice.

Finally, the BSR Regulation would need to be consistent with the objective of preserving the functioning of global trading markets. For example, the importance of market makers and underwriters to market liquidity and the benefits they provide of lower cost of capital and more access to capital and credit markets for companies would need to be taken into account. A narrow market-making definition as well as requiring separation of market making activities and limiting other permitted trading activities in the core credit institution (such as derivatives, where only certain cleared derivatives are out of scope for potential separation) could lead to unintended consequences, such as a reduction in market liquidity, that could impair the availability of credit and would damage the real economy – impacting SMEs and consumers.

Current status (in the legislative process): After months of negotiations the Council agreed its position on the text on 19 June 2015 and proposed important changes to the Commission’s text. In particular it takes out some of the sting out of the Commission’s original proposal by introducing the mandatory separation of proprietary trading instead of its prohibition. It incorporates a more flexible and risk-based approach by setting out a range of options for competent authorities to take on trading activities. Separation is no longer the only measure to be adopted, but an additional one in the authorities’ toolkit.

Despite this progress in the Council, the BSR Regulation is currently stuck in the ECON Committee of the European Parliament with the political parties unable to agree on a draft text. While future movement is possible, there has been no progress on the file for over two years, and while it has not been officially withdrawn progress and significant compromise is unlikely.

b) EU Bank Recovery & Resolution Directive (BRRD)

A summary of the issue and current status
By way of reminder we covered the key provisions of the original BRRD in the last edition of this guide. The BRRD established the EU framework to manage bank failures in a way that avoids financial instability and minimises costs for taxpayers. Moreover, the Single Resolution Mechanism Regulation (SMRR) sets out specific provisions for Member States participating in the Banking Union when banks need to be resolved. The BRRD and the SRMR form the EU resolution framework, which provides
competent authorities with comprehensive and effective arrangements to deal with failing banks, as well as cooperation arrangements to tackle cross-border banking failures. The key objectives of the EU resolution framework, in line with efforts at international level, are to preserve the continuity of banks’ critical functions while avoiding the use of taxpayers’ money and adverse effects on the financial system.

On 23 November 2016, the European Commission published proposals for amendments to the Bank Recovery and Resolution Directive (BRRD). These proposals should be seen as a package with the CRD V/CRR II proposals (which include the minimum Total Loss Absorbing Capacity (TLAC) requirements) which are covered in the Basel III in Europe section above.

Key features:
Creditor hierarchy: We explained in detail in the last edition of this guide that different countries in the EU adopted different approaches with respect to creditor hierarchy and that this came to light with the various bank bail-in experiences. While it was clear that in the event of a bank failing, shareholders would be bailed-in first, the fate of bondholders was less obvious. This led to different solutions for dealing with bank assets being adopted in different countries. As a result of these divergent approaches it therefore comes as no surprise that the Commission has decided to amend the BRRD. The Commission has proposed to harmonise the bank insolvency creditor hierarchy in relation to the ranking of holders of senior unsecured debt eligible to meet the BRRD rules and the TLAC standard. The new provision would create a new asset class of non-preferred senior debt that can be bailed in in resolution, after other capital instruments, but before senior liabilities.

Harmonising the minimum requirement for own funds and eligible liabilities (MREL) and TLAC: The Commission is proposing to introduce a minimum harmonised MREL requirement applicable to G-SIBs only and in line with the scope of the TLAC standard. Resolution authorities are able to require G-SIBs to comply with additional MREL requirements under Pillar 2. A bank-specific MREL under a Pillar 2 approach will be set for non-G-SIBs, defining their total-loss absorbency requirements. The Commission has also proposed a number of constraints on host resolution authorities to set higher levels of loss absorbency for banks under a range of circumstances.

Third-country provisions: The Commission’s proposal also addresses the need for proportionality of bail-in related rules by revising a specific article (Article 55) of the existing BRRD under which banks have to include in contracts that are governed by the law of a third country a clause by which the creditor recognises the bail-in power of the EU resolution authorities.
Next steps:
The proposed amendments are going through the EU legislative process, negotiations and discussions with the European Parliament and the Council. We anticipate that these will come into force by 2019.

Implications for banks:
On the back of the BRRD banks had to prepare detailed recovery plans to overcome early financial distress. The BRRD impacted European banks as well as branches and other legal entities of non-European banks that are located in the EU. This meant that recovery and resolution plans of international banks operating in Europe will were shared with relevant local regulators. The proposed changes to the BRRD will help remove some of the divergences that were created when EU Member States transposed the original directive. Such discrepancies have the potential to amplify uncertainty for debt issuers, investors and resolution authorities and to make the application of the bail-in tool in cross-border resolution cases legally more complex and less transparent. At the same time, the buy-side would experience information asymmetry among different EU jurisdictions, rendering the process of pricing risk more cumbersome. The resulting uncertainty could also trigger competitive distortions because unsecured debt holders could be treated differently in different Member States and the MREL compliance costs for banks may be different according to the location of the issuance.

The BRRD will affect European banks as well as branches and other legal entities of non-European banks that are located in the EU. This will mean that recovery and resolution plans of international banks operating in Europe will also need to be shared with relevant local regulators.

c) U.S. Volcker Rule
We covered the Volcker Rule and its implications in previous editions of this guide. By way of reminder the Volcker Rule bans banks from proprietary trading and is one of the most ‘famous’ parts of the Dodd-Frank post crisis regulatory reform. The U.S has now taken the first steps towards reviewing the Volcker Rule.

On 2 August 2017, the Office of the Comptroller of the Currency (OCC) announced that it is seeking public input on revising the final regulation implementing section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (commonly known as the Volcker Rule). The OCC sent to the Federal Register for publication a notice that solicits public input on whether certain aspects of the implementing
regulation should be revised to better accomplish the purposes of section 619 while decreasing the compliance burden on banking entities and fostering economic growth. In particular, the OCC invites input on ways to tailor the rule's requirements and clarify key provisions that define prohibited and permissible activities. The OCC also seeks input on how the federal regulatory agencies could implement the existing rule more effectively without revising the regulation. The public is invited to provide supporting data that can inform specific changes to the regulation, and help assess the effectiveness of implementation efforts to date.

The request for comment can be found here and is open for 45 days from 2 August: https://www.occ.treas.gov/news-issuances/news-releases/2017/nr-occ-2017-89a.pdf

The other federal agencies with concurrent rule writing authority over the Volcker Rule, namely, the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Securities and Exchange Commission, and Commodity Futures Trading Commission - did not release the request for input (RFI) jointly with the OCC. The preamble to the RFI acknowledges that any revisions to the current regulation will need to involve those agencies. Some of the other agencies are still led by appointees of President Obama which may make it less likely for them to support the reform of the regulation in the near term. The RFI covers questions on the scope of firms subject to the rule, the proprietary ban, the covered funds prohibition and questions on the compliance program, metrics reporting and additional issues.

At the time of writing it is too early to discuss impacts.

4) Taxation measures

a) OECD BEPS

A summary of the issue and current status
As set out on the OECD's website, BEPS refers to tax planning, which seeks to exploit cross border gaps and mismatches in tax laws to reduce the overall tax liability - “to make profits ‘disappear’ for tax purposes or to shift profits to locations where there is little or no real activity”. The OECD launched an Action Plan on BEPS and identified 15 Actions to be developed in 2014 and 2015 to more closely align taxation with economic activities and results and thus prevent “double non-taxation”. Considerable debate continues around implementation, consistency, approach to development countries and tax competition between jurisdictions.
BEPS Actions cover the following areas:

1. Digital Economy
2. Hybrids
3. CFC (Controlled Foreign Company) Rules
4. Interest Deductions and other Financial Payments
5. Harmful Tax Practices
6. Treaty Abuse
7. Artificial “Permanent Establishment” Status
8. Transfer Pricing: Intangibles
9. Transfer Pricing: Risk and Capital
10. Transfer Pricing: Other High Risk Transactions
11. Methodologies to Collect and Analyse Data
12. Disclosures of Aggressive Tax Planning Structures
13. Transfer Pricing Documentation
14. Dispute Resolution Mechanisms
15. Multi-lateral Instrument

On 5 October 2015 after an intensive two-year consultation process between the OECD, the G20, developing countries and numerous stakeholders, the OECD published the final report on all 15 Actions.

Key Points
The final BEPS package contains recommendations on:

• minimum standards: the recommendations on harmful tax practices (Action 5), treaty abuse (Action 6), country-by-country reporting (Action 13) and dispute resolution (Action 14);
• Reinforced international standards: the revised OECD Transfer Pricing Guidelines (Actions 8-10) and the revised OECD Model Tax Convention (including Action 7 on permanent establishment status);

• Common approaches and best practices for domestic law: Hybrid mismatch arrangements (Action 2), controlled foreign company rules (Action 3), interest limitations (Action 4) and disclosure of aggressive tax planning (Action 12);

• Analytical reports: tax challenges of the digital economy (Action 1), data and analysis with respect to BEPS (Action 11) and the multilateral instrument for implementing treaty based recommendations (Action 15).

Tax Havens
The Actions typically seek to address the issues posed by tax havens unilaterally. For instance, CFC’s tax the earnings of tax havens at the parent level, the hybrid instruments paper effectively denies tax deductions on payments on hybrid instruments where the recipient is not taxed; country by country reporting allows Tax Authorities to see where a group has earned its profits and paid tax so that they can risk assess audit work.

Implementation
The OECD itself is not a legislative body. The implementation timeline is phased depending on the actual measure with some being implemented by countries from 2016 onward, whilst others are directly applicable (like the revised guidance on transfer pricing). Certain measures will require changes to countries’ domestic legislation before taking effect whilst others will need to be included within multilateral instruments or negotiated into double tax treaties; note that the work to develop a multilateral instrument has already started with around 90 jurisdictions participating. In the EU for example BEPS is being implemented via a Directive (the Anti-Tax Avoidance Directive) that will be transposed by EU Member States by 31 December 2018.

Following the endorsement of the BEPS package by the G20 Finance Ministers (October 2015) and by the G20 leaders (November 2015), the focus has shifted towards ensuring consistent implementation and monitoring of the impact of the different measures. To assist in this process the G20 has requested a proposal for a more inclusive framework, which the OECD agreed on during February 2016. The new framework would allow all interested countries and jurisdictions to join in efforts to update international tax rules. On June 30, 2016 representatives of over 80 countries and jurisdictions gathered in Kyoto, Japan to launch their participation
in the new framework making this the first time a broad range of countries, representing varying levels of development, have come together on an equal footing in the OECD’s Committee on Fiscal Affairs. Since then a range of countries continue to join the inclusive framework and more jurisdictions signed tax co-operation agreements to enable automatic sharing of country by country information. During the course of 2017 the OECD released additional guidance documents on country by country reporting (18 July) and transfer pricing (10 July). The guidance documents are important as they clarify questions of interpretation that jurisdictions are raising as they move towards implementation. They are also important in the interests of consistent implementation and certainty for both tax administrations and taxpayers and will be periodically updated by the OECD. The documents can be found here:


Industry and business has a significant interest in the BEPS work succeeding to produce a cohesive international tax framework. Without this, unilateral actions have the potential to create inconsistency and cross-border disputes. While one of the Actions is Dispute Resolution, at present it does not mandate binding dispute resolution. OECD is now gathering taxpayer input on peer reviews of Dispute Resolution. Three batches of reviews have already been launched during the course of 2017 and we anticipate additional batches until 2020. The peer reviews are formed on the basis of a key document published in October 2016 which can be found here http://www.oecd.org/tax/beps/beps-action-14-on-more-effective-dispute-resolution-peer-review-documents.pdf.

For further information on BEPS please refer to the 2015 Final Reports, the Explanatory Statement and Information Brief

Implications for Corporates
Of particular relevance for corporates the BEPS Actions 2, 3, 4, 9 and 13 merit a closer look.

Looking at Action 2, Hybrid Mismatches a consequence of this Action could be the potential increase in the group’s cost of debt, which may lead to the need for considering debt restructuring. Inefficiencies in intra-group liquidity and funding structures may be triggered by the CFC rules under Action 3. Further cost of debt increases and associated impacts on funding decisions as well as cash management
structures will have to be considered around Action 4. The Transfer Pricing related Actions 9 and 13 will on the one hand require more transparency of treasury and financial operations to relevant countries, whilst on the other hand the risk and capital dimension will require alignment of value creation and profits, which will have repercussions on treasury and cash management operations, their structure and even potentially the location of treasury centres.

As OECD Actions and ensuing national implementation of these unfold Citi will continue to monitor and update clients.

b) Common Reporting Standard

A summary of the issue and current status

The Foreign Account Tax Compliance Act (FATCA) is a U.S. tax legislation that aims to prevent or detect tax evasion by U.S. Persons who 1) hold bank deposits and/or securities in offshore accounts, or 2) own foreign investment entities (e.g. personal investment corporations and trusts). FATCA was enacted into law on 3/18/2010 as part of the HIRE ACT and added new Chapter 4 to the Internal Revenue Code. FATCA paved the way for the global expansion of intergovernmental reporting. It therefore came as no surprise when on February 13, 2014 the Organisation for Economic Co-operation and Development (OECD) at the request of the G8 and G20 the OECD released a model Competent Authority Agreement (CAA) and Common Reporting Standard (CRS) designed to create a global standard for the automatic exchange of financial account information. The standard has no direct legal force but it is expected that jurisdictions will follow the model CAA and CRS closely when implementing bilateral agreements.

CRS is drawn largely from the Model 1 intergovernmental agreement (IGA) that many countries have entered into to implement FATCA. The CRS sets forth the standard rules under which financial institutions are required to collect information and documentation from account holders about their tax residence status and to report certain personal (for example, name, address, tax residence country or countries and taxpayer identification number) and financial (for example, account number, account balance and amounts paid into the account) information to the local tax authority. In turn, the local tax authority will annually exchange information on tax residents in other countries with which the reporting country has entered into a Multilateral Competent Authority Agreement or Competent Authority Agreement. Over 90 countries have committed to implement the CRS over the next few years and there is significant political will to implement CRS early. As at June 2017, 101 jurisdictions have committed to automatic exchanges of tax information. Of those 101 jurisdictions, 50 have committed to their first exchange by 2017 and 51 have committed to
undertake their first exchange by 2018. A full list can be found here https://www.oecd.org/tax/transparency/AEOI-commitments.pdf and a more detailed jurisdiction specific overview as at 3 August 2017 can be found here: http://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/crs-by-jurisdiction

The subtle differences between FATCA and the CRS mean that financial institutions cannot solely leverage off their FATCA implementation efforts in order to comply with the CRS. A proper gap analysis needs to be conducted and to benefit from efficiencies firms may wish to consider a strategic approach that combines the requirements of both FATCA and the CRS. One important differentiator between the two regimes is that whereas FATCA focuses on identifying the account holder’s citizenship; the CRS concentrates on the account holder’s country of tax residence. Unlike FATCA, the CRS does not impose a 30% withholding tax for noncompliance. This is left to the participating jurisdiction to determine.

The OECD has published their latest set of FAQ’s (April 2017) along with an Implementation Handbook which although not part of the CRS per se, provides a practical guide to implementing the CRS and includes a comparison between the CRS and FATCA. These documents can be found here:


EMEA

1) Brexit

A summary of the issue and current status
The UK held a referendum on whether to remain within the EU on 23 June 2016. By way of reminder the referendum on Britain’s membership of the European Union was announced in David Cameron’s speech on the future of Europe on 23 January, 2013. After a long and thorough debate, the British public voted to leave the European Union. There is no immediate change for the UK and its position in the EU as the UK still needs to go through a lengthy ‘divorce process’ before it formally exits the EU.

In particular, the UK has a two year period to negotiate a withdrawal agreement as per the ‘exit clauses’ in Article 50 of the Lisbon Treaty. Divorcing from the EU is not a straightforward process. This gives corporates time to examine potential risks in relation to their treasury operations, clearing and liquidity solutions. During this 2 year period there will be no change in the way Citi is able to conduct its business. The clock started ticking on the 2 year period when the UK government served notice under Article 50 on 29 March 2017.

During the course of 2015 Citi created a group of senior leaders from across our businesses and functions to ensure we were prepared for this possible outcome. This group is continuing to work on our Brexit planning. We remain confident that we will be able to continue to serve our clients without any material disruption. Citi is dedicated to ensuring the provision of service to our customers and seamless migration, leveraging the strong and diversified footprint across 21 of the 27 EU/EEA states. Our own Brexit planning is based on the assumption of the worst case scenario, where the UK will become a 3rd country post Brexit (a hard Brexit). In the last edition of this guide we covered the different Brexit models and their implications for the financial services regulatory landscape in detail. During the course of 2017 regulators at both national and EU level have started to give guidance on the back of Brexit. The European Central Bank for example has a section on its website with Brexit FAQs. At a national level the German regulator - BaFin also has a website with FAQs on Brexit.

PART II: Regional regulatory and market changes
Citi has organised (and will continue to organise) a series of client briefing calls discussing the treasury implications of the EU referendum and Brexit for corporates. Please do not hesitate to reach out to your relationship manager for details and for any questions you may have.

**Impact on treasurers**

Trade and Supply Chain: The countries you trade within the EU and potential alternative partnerships. Manufacturing rules of origin: do you manufacture in the UK using products sourced internationally? The need to restructure your supply chain and its financing.

Tariff and Non-Tariff Barriers: The impact of new tariffs on your trading arrangements.

Regulation and Certifications: The cost of complying with different certification requirements and multiple regulations.


**Mitigating the impact on your treasury flows**

SEPA Transactions: Corporates with a large number of SEPA transactions from UK accounts may have to migrate these transactions to EEA based accounts.

Treasury high value flows from UK to EU: Transactions originating from UK based EU currency accounts may lose full value protection under the Payment Services Directive and transaction costs may increase. Corporates with a large number of EU currency transactions from UK accounts may have to migrate these transactions to EEA based accounts.

Treasury High Value flows from EU to London: Payments from EU based currency accounts to UK beneficiaries may lose full value protection under the Payment Services Directive and transaction costs may increase, e.g. GBP. Corporates with a large number of GBP transactions from EU accounts may have to migrate these transactions to GBP accounts in London.

**Brexit impact on pooling structures**

The impact on a pooling structure is not a function of account location. It is a function of the tax domicile of the constituent entities.
UK domiciled treasury entity: There may be withholding tax implications on flows between UK header and EU participants accounts (i.e. Cypriot, Italian, Polish, Portuguese and Romanian entities) because relief from interest withholding tax will no longer be available under the EU Interest and Royalties Directive. Instead, this will depend on bilateral tax treaties.

Mitigation: Consider disengaging the impacted subsidiary/pool participants from the cash pool arrangement in order to ensure access to EU directives.

EU domiciled treasury entity: The impact is limited to the flows between the header and any UK domiciled source account.

Mitigation: If there is an impact, consider disengaging UK domiciled treasury entities.

Non-EU domiciled treasury entity: There is no impact.

2) Payments

a) The Single Euro Payments Area (SEPA)

SEPA aims to deliver efficiencies and economies of scale by removing today’s fragmentation around Eurozone local ACH schemes, formats and systems. The goal of the initiative is to achieve an integration of the retail payments space for the euro and enable effective competition between banks/payment service providers (PSPs) at domestic and pan-European levels.

Following the implementation of “SEPA Migration End-Date Regulation” in 2013, the usage of SEPA has steadily increased. The Regulation applies to the twenty-eight European Member States along with the remaining EEA countries Iceland, Norway and Liechtenstein.

The next development in the SEPA journey is the emergence of SEPA real-time payments. The European Retail Payments Board (ERPB), which was established in 2013 as the successor of the SEPA Council (co-chaired by the ECB, with EU Commission as observer), decided in December 2014 to prioritise the delivery of a future instant payment solution for Europe.

Given the fact that national instant or faster payment solutions have been developed within a number of EU countries, “the ERPB agreed on: the need for at least one pan-European instant payment solution for euro open to any regulated payment service provider (“PSP”) in the EU.”
Subsequently the ERPB tasked the European Payments Council (EPC), as one of the key stakeholders of the ERPB (and owner of the SEPA schemes), to prepare a vision for a future SEPA instant credit transfer scheme. As a next step the EPC worked on creating the scheme and consulted on the draft proposal with the payments market in Europe in 2016.

SEPA Instant will be officially launched as a scheme in November 2017. SEPA Instant payments are going to be an additional service to existing SEPA solutions. The delivery of the SEPA Instant Payment Scheme and process will be optional for banks and payment services providers to offer.

SEPA Instant will enable euro credit transfers with the funds made available on the account in less than ten seconds at any time and in an area that will progressively span over 34 European countries. The technical information for implementing the scheme is available under the following link: https://www.europeanpaymentscouncil.eu/what-we-do/sepa-instant-credit-transfer/sepa-instant-credit-transfer-rulebook

Implications for corporates
From a corporate perspective, SEPA instant payments, similar to Faster Payments in the UK, would provide a third payment option in Europe in addition to TARGET 2/Euro1 high value clearing and the traditional SEPA credit transfer ACH-type payments

b) The European Payment Services Directive II (PSD)

A summary of the issue and current status
The original Payment Services Directive (PSD 1), which covers all electronic payment transactions in currencies of the EEA that are executed between banks and other PSPs located within the EEA (CTs, DDs, card payments), has been going through a review process. In July 2013, PSD 2 was issued as a proposal by the European Commission. After more than two years of negotiation, the revised Payment Services Directive (PSD 2) has been published in the Official Journal of the European Union on 23 December 2015 (this text is also known as the Level 1 text). The text of the PSD 2, which is named Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC, is available through the following link: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.337.01.0035.01.ENG&toc=OJ:L:2015:337:TOC
The market has until January 2018 to comply with the requirements set out in the Directive text. Furthermore, several guidelines and regulatory technical standards (RTS) will have to be complied with between 2018 and 2019, as part of the Level 2 legal texts prepared by the European Banking Authority (EBA).

At an EU industry level Citi has been leading industry efforts to prepare a guidance document that supports banks’ and PSPs’ compliance (as chair of the EBF, Payments Regulatory Expert Group). A full overview of PSD2 including implementation guidance for the Level 1 PSD2 text has been prepared under Citi’s leadership with the European Banking Federation and can be accessed under the following link:


The Directive now covers third party payment services (TPPs) that fall under the definition of payment institution, which will be able to offer new types of payment services such as payment initiation services, account information services and payment instrument issuance. There are two types of TPP:

1. Payment initiation service providers (PISP). Those providing software bridge between a payer and a PSP in order to facilitate online payments by initiating an order at the request of the payer.

2. Account information service providers (AISP). Those providing payment service users with an overall view of their financial situation on several accounts with different providers.

As a consequence, a set of new provisions obliging the account servicing payment service provider (ASPSP) to disclose information to TPPs on the availability of funds for a specified payment transaction as well as to enable secure communication between a TPP and itself to support payment initiation services, are also being introduced.

To enhance the security for client payments, in particular when TPPs are playing an intermediary role, the EBA is soon to publish its final RTS on Secure Customer Authentication (SCA). This will stipulate requirements to enhance security of the client and transaction authentication process. Following many negotiating hours it is also now likely that the final RTS will not endorse ‘screen scraping’, i.e. the possibility of TPPs to directly use client online banking authentication credentials to ensure client accounts. We will see in autumn what the final requirements will say. Deadline for implementing the RTS on SCA is likely going to be towards the second half of 2019.
Next steps
The EBA is required to still publish a number of guidelines and RTS as part of its mandate under PSD 2. Citi will continue to drive the response from the industry level via the European Banking Federation (EBF) Payments Regulatory Expert Group and for security specific matters via the European Payments Council (EPC) Payment Security Group.

We continue to engage with the relevant authorities and Member States during the transposition phase to help shape common interpretations that will benefit both providers and users of payment services. An addendum to the PSD2 guidance that will capture relevant Level 2 requirements is planned to be published for 2019.

Implications for banks and their clients
Citi has been very active in supporting regulators in their drafting of PSD II. We continue our deep engagement by driving industry consensus and advocacy in relation to PSD II as chair of the EBF Payments Regulatory Expert Group as well as the EPC Payment Security Group.

3) Securities custody, clearing and processing
a) European CSD Regulation

CSDR is an integral part of the EU regulatory initiatives aiming to cover all aspects of the financial sector:

• MiFID / MiFID2: focus on trading of securities and on financial markets and trading venues;
• EMIR: focus on clearing of financial instruments generally (but in particular derivatives) and on central counterparties;
• CSDR: focus on settlement and on central securities depositories;
• Securities Law Legislation (still in pre-proposal stage): focus on holding/custody, taking of “security” over securities, and on the legal certainty of securities holdings and transfers.
The main objectives of CSDR are to:

- Increase the safety of settlements, in particular for cross-border transactions, by ensuring that buyers and sellers receive their securities and money on time and without risks;
- Increase the efficiency of settlements, in particular for cross-border transactions, by introducing a true “internal market” in the EU for the operations of national CSDs; and to
- Increase the safety of CSDs by applying high prudential requirements in line with international standards.

CSDR consists of two main parts:

- Uniform requirements for the settlement of financial instruments in the European Union - Focused on settlement activities, addressing all market participants;
- Rules on the organisation and conduct of CSDs to promote safe and smooth settlement - Focused on CSDs’ organisation.

The regulation applies to all CSDs in the European Union (including International Central Securities Depositories (ICSDs)). In addition to CSDs themselves, EU issuers of transferable securities, MiFID investment firms, CSD participants (wherever located; not just EU entities), central counterparties, trading venues and financial institutions that internalise settlements are also impacted and will have to directly comply with some of the measures.

**Highlights of the new CSD Regulation**

The Regulation aims to harmonise securities settlement across the EU, to regulate Central Securities Depositories (CSDs) across the EU and to create a system of authorisation and passporting for European CSDs which is intended to help remove existing barriers of access to the market.

In terms of post-crisis reform of financial market infrastructure, the Regulation can be seen as the settlement world’s adjunct to EMIR (for clearing) and MiFID 2 (for trading).

As mentioned above, the CSDR consists of two main parts:

Part One is focused on settlement activities, with a wide scope addressing all market participants and covering dematerialisation of securities, harmonisation of settlement cycles to T+2 and more stringent settlement discipline measures.
Part Two is focused on CSDs' organisation, segregation of clients' assets, mandatory use of central bank money for settlements, where this is available and practical, and on the removal of Giovannini Barrier 9 on securities issuance (issuers will be allowed to issue in the CSD of their choice).

One key aspect addressed by CSDR is the authorisation and supervision regime for CSDs. The new rules establish mandatory separation of core services (to be authorised under a “CSD license”), i.e. central custody, notary function and settlement function based on Central Bank Money settlements, from other ancillary services such as intraday credit facilities, collateral management and securities lending services (which will be allowed only under a separate banking license).

The main rationale for this separation is to ensure systemic protection of the core market infrastructures, which deliver a (other than operational risk) utility service with a minimal amount of risk, versus other services and functions, which by their nature create additional risks (credit risk, liquidity risk, counterparty risk, etc.).

The CSDR is designed to create a level playing field of custody services regardless of whether they are provided by CSDs or custodian banks. Regulators would like to increase the transparency in this space and have established that any value-added services provided by CSDs should be subject to standard banking regulation. The CSDR also forms the legal basis for the establishment of a common T+2 settlement cycle.

**T+2 settlement period:** Participants connecting to CSDs are now subject to a shortened settlement period for certain transactions executed on a trading venue. The move to T+2 came into effect on 1 January 2015, but many of the markets implemented the shorter settlement period on 6 October 2014.

**Settlement Discipline:** CSDs, CCPs and trading venues must have procedures to ensure timely confirmations and settlements (where appropriate). Measures include penalty provisions (including cash), mandatory buy-ins (“failing participant” must buy/ borrow securities to resolve “failing settlements”) and suspension measures. Investment firms must have arrangements to limit settlement fails. Penalties may apply regardless of fault so there is potential to be liable for third party action/ omission particularly for custodians providing settlement services.

**Segregation of accounts:** EMIR-like obligation apply for participants in a CSD to (i) offer clients choice between omnibus and individual client segregation (ii) publicly disclose levels of protections and costs associated with segregation and (iii) offer these services on reasonable commercial terms. Implementation will be required at the earliest by mid-2018, upon individual CSD authorisation.
**Settlement Internaliser**: Where banks’ European based legal entities settle transactions on their own accounts (i.e. outside of a securities settlement system), they will be required to report these transactions on a quarterly basis.

**Implementation timeline and next steps**
CSDR was published in the Official Journal of the EU on 28 August 2014 and entered into force 20 days after its publication, i.e. on 17 September 2014.

The Regulation is directly applicable in Member States though Level 2 measures (Regulatory and Implementing Technical standards) are required to implement a number of its provisions. Most articles in CSDR apply once Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) enter into force, and/or CSDs have re-applied for and been granted authorisation.

**Level 2 measures:**
On 10 March 2017, six “Level 2” measures under CSDR were published in the Official Journal of the European Union, covering various areas requiring technical standards (such as the parameters for the calculation of cash penalties for settlement fails; prudential requirements for CSDs; details on the content of the reporting on internalised settlements; regulatory technical standards on authorisation, supervisory and operational requirements for CSDs).

With the exception of the RTS measures on settlement discipline (which are expected later in 2017 - ESMA has submitted draft RTS to Commission for endorsement on February 2016), all measures have now been endorsed.

The above Level 2 measures entered into force 20 calendar days after publication in the Official Journal meaning Thursday 30 March 2017 marked the start of the application period for CSD authorisation. EU CSDs/ICSDs have six months - i.e. until 30 September 2017 at the latest - to apply to their competent authority for authorisation under CSDR. Authorisation can be expected within six months after a CSD’s application is considered complete by the relevant competent authority, but will depend on a case by case basis.

**Implications for banks and their clients**
In the short-term the legislation is likely to create more competition between the CSDs in Europe. Whilst in the medium to long term, a possible outcome is a more consolidated and less fragmented market which may in turn result in safer and less costly cross-border settlement. Cross-border settlement could also become safer and cheaper.
Any resulting reduction in costs for settling and holding securities has potential to stimulate growth, as a consequence of the ease in raising capital. SMEs may benefit more relatively because they would face proportionally lower costs from CSDs for issuance and custody of their securities.

The dematerialisation of securities is a very positive step, given that it takes more than three times longer to settle a transaction in paper securities than a transaction in securities held in book entry form. The key objective is to set a maximum settlement period of T + 2. Holders of securities in paper form will however be able to keep them in paper form until 2025.

**b) European Post Trade Reform**

On 23 August 2017 the European Commission launched a public consultation on possible actions to enhance the operational efficiency of post trade securities services in Europe and published the European Post-Trade Forum (EPTF) Report. These initiatives are part of the Commission’s on-going work in the context of the Capital Market Union (CMU). The Commission’s press release notes that the purpose of this consultation is to learn industry stakeholders’ views about the current state of post-trade markets, the main trends and challenges faced by post-trade services providers and their users, and to determine the existence and scale of remaining or new barriers, the risks associated with such barriers and the best ways to address them. Some barriers are being addressed by on-going actions (e.g. code of conduct on withholding tax procedures) and reviews of existing legislation (e.g. EMIR). The results of this consultation will feed into future legislative reviews and contribute to the communication on post-trade planned for the end of 2017.

The EPTF Report identifies 12 EPTF Barriers (summarised below) in four areas covering operational, structural, and legal and tax issues. It also contains a series of pragmatic recommendations for reforms, mainly addressed at the Commission and other EU legislators. These EPTF Barriers and the related proposals for their removal have been carefully calibrated amongst participating members, as a realistic and pragmatic tradeoff between urgency and complexity, seeking to identify areas where most significant benefits could be reasonably achieved with a relatively manageable effort over the next 18-24 months. The EPTF consists of 16 members representing trade associations of all major stakeholders involved in post-trade services in Europe, including issuers, intermediaries, banks, fund managers, central clearing houses and central securities depositories. Citi has been directly involved and chairs the European Post-Trade Working Group at the European Banking Federation (EBF).
The EPTF Report identifies a total of 12 “EPTF Barriers” in four areas:

• Operational Barriers:
  + EPTF Barrier 1: Fragmented corporate actions and general meeting processes
  + EPTF Barrier 2: Lack of convergence and harmonization in information messaging standards
  + EPTF Barrier 3: Lack of harmonisation and standardisation of ETF processes

• Structural Barriers:
  + EPTF Barrier 4: Inconsistent application of asset segregation rules for securities accounts
  + EPTF Barrier 5: Lack of harmonisation of registration and investor identification rules and processes
  + EPTF Barrier 6: Complexity of post-trade reporting structure
  + EPTF Barrier 7: Unresolved issues regarding reference data and standardised identifiers

• Legal Barriers:
  + EPTF Barrier 8: Uncertainty as to the legal soundness of risk mitigation techniques used by intermediaries and of CCPs’ default management procedures
  + EPTF Barrier 9: Deficiencies in the protection of client assets as a result of the fragmented EU legal framework for book entry securities
  + EPTF Barrier 10: Shortcomings of EU rules on finality
  + EPTF Barrier 11: Legal uncertainty as to ownership rights in book entry securities and third party effects of assignment of claims

• Tax Barrier:
  + EPTF Barrier 12: Inefficient withholding tax collection procedures
The EPTF Report also contains a detailed analysis of five other barriers, (EPTF Barriers “on watchlist”) that are already visible and potentially emerging over the next few years, but that do not require immediate or urgent action:

- EPTF Barrier WL1: National restrictions on the activity of primary dealers and market makers (former Giovannini Barrier 10);
- EPTF Barrier WL2: Obstacles to DvP settlement in foreign currencies at CSDs;
- EPTF Barrier WL3: Issues regarding intraday provision of credit to support the settlement process;
- EPTF Barrier WL4: Insufficient collateral mobility;
- EPTF Barrier WL5: Non-harmonised procedures to collect transaction taxes (formerly Giovannini Barrier 12).

Finally, the EPTF Report describes the reasons for the EPTF’s assessment that some of the Giovannini barriers are dismantled or not in need of further action (barriers 2, 4, 5, 6 and 7 of the first “Giovannini Report”, 2001).

**Next steps:** The work of the EPTF represents an important opportunity for further harmonisation and integration of post-trade services in the context of all EU market infrastructures and business processes that support the establishment of strong and efficient capital markets in Europe. In addition, the Commission is seeking to receive further feedback from all interested stakeholders by 15 November 2017 on the needs and priorities for legislative actions in the area of post-trade securities services. Citi will continue to participate in shaping the direction of regulatory travel.

The EPTF Report is available here: http://ec.europa.eu/info/files/170515-eptf-report_en

The consultation on post trade is available here: https://ec.europa.eu/info/consultations/finance-2017-posttrade_en

4) **Securities infrastructure**

a) **European Market Infrastructure Regulation (EMIR)**

We covered at length in the last edition of this guide the history behind EMIR, the key provisions, timelines for compliance and impacts for banks and their clients and inconsistencies between EMIR and its U.S equivalent (Dodd Frank Title VII). We also mentioned that EMIR was due to be reviewed- like every piece of EU legislation it is
subject to review clause. It therefore comes as no surprise that the developments since our last guide are in relation to the review of EMIR. On 4 May 2017, the European Commission published a legislative proposal amending EMIR reflecting the outcome of its review of how EMIR has worked since its adoption in 2012. It is important to note that the proposals are not a fundamental reform of EMIR. Rather they set out a limited number of changes (which can still have a significant impact on the market) addressing issues identified in the review.

The main changes of interest relate to:

**Reporting requirements:**
- Under the proposal, reporting requirements are being streamlined for all counterparties. This will considerably reduce the administrative burden, while ensuring that the quality of data needed for monitoring derivatives markets and identifying financial stability risks is not lost. In particular, derivative transactions concluded on exchanges (so-called ‘exchange-traded derivatives’) will now only be reported by the CCP on behalf of both counterparties. To reduce the burden for all non-financial counterparties (corporates), transactions concluded between companies belonging to the same group (so-called ‘intragroup transactions’) will not have to be reported any longer, if one of the counterparties is a non-financial company. To reduce the burden for small non-financial counterparties, transactions between a financial counterparty and a small non-financial counterparty will be reported by the financial counterparty on behalf of both counterparties. Reporting on historic transactions will no longer be required. In addition, the proposal aims to improve the quality of reported data.

**Non-financial counterparties (NFCs):**
- Non-financial counterparties (for example corporates), use OTC derivatives to cover themselves against risks directly linked to their commercial or treasury financing activities (‘hedging’). Also in the future, only non-hedging contracts are counted towards the thresholds triggering the clearing obligation. While under the current rules NFCs must clear all derivatives, if they exceed the clearing threshold for one class of derivatives, the Commission is now proposing that NFCs clear only the asset classes for which they have breached the clearing threshold, thereby reducing the burden for NFCs as they only have to centrally clear the asset classes in which they are most active.
Financial counterparties:
• Small financial counterparties are numerous but account only for very small volumes of OTC derivatives and of systemic risk. They currently have significant difficulties to find clearing services providers. The proposal introduces a clearing threshold for small financial counterparties, such as small banks or funds. This clearing threshold is based on the volume of OTC derivatives transactions. While all financial counterparties are required to report and collateralise OTC derivative transactions, only counterparties exceeding that threshold would be required to clear centrally.

Pension funds:
• Pension funds typically enter into OTC derivative transactions to protect their long-term liabilities to current and future pensioners against complex market risks. While central clearing of such transactions appears important, pension funds do not have normally access to the necessary cash collateral, and no specific solutions have been developed so far. Today’s proposal introduces a new three-year temporary exemption for pension funds from central clearing. This will allow the various counterparties involved, including pension funds, central counterparties and the clearing members that provide clearing services, to develop a solution that enables pension funds to participate in central clearing without negatively impacting the revenues of future pensioners.

Impacts to corporates: The reporting obligations under the original EMIR have been of particular burden to corporates and following industry lobbying it is encouraging to see that these are being softened in the review. Pension funds will also welcome the new exemption.

Next steps: the legislative proposal is making its way through the EU’s legislative process. We anticipate that it will be finalised and published in the Official Journal at the end of 2018- although this timeline can slip. Most (but not all) of the changes will take effect immediately when the Regulation enters into force 20 days after publication in the EU’s Official Journal without any transitional arrangements or conformance period, however, changes relating to the clearing threshold, insolvency protections and the new transparency obligations which will take effect six months later and changes relating to the new obligations on clearing firms, changes to the standards on margins and changes relating to trade repositories will take effect 18 months after the entry into force.

The proposal for the review of EMIR can be found here:
5) The investment industry

a) European Markets in Financial Instruments Directive/Regulation (MiFID II /MiFIR)

In our last guide we covered the provisions of MiFID II and the issues they raise for banks and investment managers along with the timeline for transposition and compliance.

The recent developments we have observed relate to Member States putting in place local law to transpose MiFID II in time for the 3 July 2017 transposition deadline. In the UK for example HM Treasury has put in place the following implementing legislation:

- Financial Services and Markets Act 2000 (Markets in Financial Instruments)
- Regulations 2017.
- Data Reporting Services Regulations 2017.

Also, the UK FCA finalised its rules implementing MiFID II by the appropriate deadline in two policy statements:

- PS17/5 (PS I) (31 March 2017), which looks at trading venues, algorithmic and high-frequency trading, and certain firm organisational requirements.
- PS 17/14 (PS II) (3 July 2017), which contains key areas of interest to investment managers, such as inducements, payments for research, best execution, client categorisation, telephone taping and client assets.

In other European developments, on 3 July 2017, the Luxembourg Chamber of Deputies released draft law 7157 (transposing MiFID II and MiFIR). Most of the topics related to the later will be regulated under a specific law, while the provision of investment services will still be covered by the law of 5 April 1993 related to the financial sector (LSF). Unfortunately, this is not the case in all EU jurisdictions.

In Ireland, on 14 July 2017, the Department of Finance issued its feedback statement on its earlier public consultation on national discretions under MiFID II. The department advised of a delay in the transposition of MiFID II and continues to work on transposing regulations. These are expected within the coming weeks.

With the end of the implementation path clear in sight the industry is busily focusing its attention on analysing the local rules and engaging with industry bodies in time for the 3 January 2018 deadline when MiFID II comes into effect.
The European Securities and Markets Authority also released its latest set of Questions and Answers to assist firms with interpretation issues in implementing MIFID II requirements.


b) European Money Market Funds Regulation

In the last edition of this guide we covered in detail the purpose of money market funds, the proposed EU-wide regulation and some similarities and differences with the approach the U.S. has taken to regulating these instruments.

After many years of negotiation between the EU institutions and industry lobbying the final Regulation on Money Market Funds was published in the EU’s Official Journal on 30 June 2017 and entered into force 20 days later.

The final version of the Regulation can be found here:


It came as great relief to the industry to see that the initial proposal for MMF that choose to have a stable value of its NAV will have to set aside a capital reserve amounting to 3% of its assets under management did not make it through to the final Regulation. The provision was heavily lobbied on by the industry.

Key points include:

The Regulation categories MMFs into 3 buckets (these are the 3 types of MMFs that were discussed during the negotiations and covered in the last edition of this guide):

• Variable NAV MMF (VNAV)
• Public Debt Constant MMF (CNAV)
• Low Volatility NAV MMF (LVNAV)

Key points include:

• Certain levels of liquidity that differ depending on the type of MMF: VNAV MMFs require at least 7.5% of daily maturing assets and 15% in weekly maturing assets. CNAV and LVNAV MMFs require at least 10% of daily maturing assets and 30% in weekly maturing assets.
• Liquidity fees and gates. Whenever the weekly maturing assets of a CNAV MMF or an LNAV MMF falls below 30% of the total assets of the MMF and whenever daily redemption request exceeds 10% of the total assets of the MMF, the MMF board of directors will consider whether it is appropriate to apply liquidity fees on redemptions, redemption gates on suspension of redemptions. Whenever the weekly maturing assets falls below 10% the board applies at least one of those measures.

• Internal credit quality assessment. MMF managers will have to establish and implement a prudent internal credit quality assessment procedure which will be reviewed annually by the management and the board.

• Various transparency / reporting requirements. For example MMF managers have to publish daily reports (published on the manager's website) for CNAV and LVNAV that state the difference between the NAV/unit applied to subscription and redemption and the NAV per unit calculated using the variable NAV methodology. Weekly reports are required for all MMFs on maturity breakdown of the portfolio, credit profile WAM, WAL, ten largest holdings and total value of assets and net yield.

• Stress testing which will be conducted regularly including factors such as changes in liquidity, credit risks, movements in interest rate, hypothetical redemption requests etc. In case the tests reveal vulnerabilities, extensive reports on the results of the stress testing will be submitted to the board of directors of the MMF and reviewed by the national competent authorities who will send them to the European Securities and Markets Authority (ESMA). ESMA will issue guidelines on stress testing that will be updated annually based on market developments.

• External support is prohibited.

Next steps: The Regulation came into force 21 July 2017. All existing MMFs have 18 months to comply with the Regulation and new funds must be in compliance by 21 July 2018.

Considerations for corporates: MMFs will still be a useful tool in the corporate treasurer’s toolbox for cash management purposes. It will be important for corporates to understand the characteristics of the 3 types of MMFs (mentioned above) and to pay close attention to the liquidity fees and gates. It is also important for investors to look at regulatory reforms across the investment landscape and as such this regulation should not be read in isolation- for example continued Basel reforms their impact on banks and their clients.
6) Funds and fiduciaries

a) The European Alternative Investment Fund Managers Directive (AIFMD)

A summary of the current regulatory development and potential issues

The AIFMD is a European Directive that lays down the rules for the authorisation, ongoing operation and transparency of managers of alternative investment funds (AIFMs). An alternative investment fund (AIF) is a collective investment undertaking that is not governed by the UCITS Directive. Its aim is to increase investor protection following the global financial crisis and the impact of Lehman and Madoff on European investment funds. It establishes common EU rules regarding the authorisation and supervision of AIFMs. The rules apply to any AIFM that has its registered offices in the EU, that manages any AIF authorised or registered in or has its registered or head office in the EU and/or that markets any AIF in the EU.

The main provisions cover the following:

• AIFMs must be authorised as “full-scope AIFMs”, able to utilise all the provisions of the Directive, or registered as “sub-threshold”, with limited permissions to market AIFs, based on the AIFM’s AIF assets under management although it should be noted that some jurisdictions (e.g. France and the Netherlands) do not recognise sub-threshold AIFMs.

• EU AIFMs may market EU AIFs to non-retail investors throughout the EU. Non-EU AIFs and EU AIFs managed by non-EU AIFMs may be marketed through a member state’s national private placement regime. The AIFMD has provisions for these non-EU AIFs and non-EU AIFMs to market using the same passport as EU AIFs however these Articles have yet to be enacted.

• An AIFM must appoint a single depository for each AIF it manages. The depository must be a credit institution, investment firm or other entity eligible under the UCITS Directive.

• Transparency requirements and conduct of business requirements.

• Capital requirements based on funds under management.

• Specific requirement for AIFMs acquiring control of stakes in companies.

• Restrictions on delegations of functions (need for authorisation/consent from relevant regulator).
• Prescription of remuneration policies.
• Mandating of organisational requirements.

Implications for the funds industry
This legislation is of strategic importance to the Securities and Funds Services business. At the time of its implementation in 2013, the AIFMD required significant changes to how custodians service clients, monitor and value risk, as well as being able to leverage their competitive position. In this context Citi has been able to provide a number of benefits in having services and expertise across the delivery spectrum.

Overall, this regulatory change has resulted in greater compliance requirements and other cost implications for asset managers; particularly private equity firms, hedge funds and depositaries. We continue to work with our clients in terms of providing clarity and solutions in the areas above.

Asset Segregation Requirements
On 15 July 2016, ESMA published a call for evidence on asset segregation and custody services under AIFMD and the UCITS V Directive (see below for UCITS V Directive). Both AIFMD and UCITS V impose asset segregation rules intended to protect the interest of investors by assuring that the assets of the AIF/UCITS are not exposed to events (such as bankruptcy) which may affect third parties to whom safekeeping of assets by the depositary are delegated (or sub-delegated). ESMA first consulted on asset segregation under AIFMD in December 2014. In it, two alternative options were proposed as possible approaches to asset segregation across Europe. The two options were as follows:

1. AIF and non-AIF assets should not be mixed in the same account and there should be separate accounts for AIF and non-AIF assets of each depositary when a delegate is holding assets from multiple depositary clients.

2. The separation of AIF and non-AIF assets should be required, as per (1) above but it would be possible to combine AIF assets of multiple depositaries into a single account at delegate level.

The consultation process was left in abeyance because most respondents strongly objected to the two options proposed and expressed a preference for other options mentioned in the original consultation paper. The principal arguments against options 1 and 2 were that the co-mingling of both AIF and non-AIF assets by a delegate and from clients of different depositaries should be permitted in an omnibus account.
(and this approach broadly reflects the current market position) and that the segregation of AIF from non-AIF assets and as between clients of different depositaries would not provide additional investor protection and would add very substantially to the costs of providing these types of services. Since the December 2014 consultation, UCITS V has been implemented across the EU and ESMA has decided to carry out a further consultation to gather more evidence to support the arguments set out by the majority of respondents to the original consultation. The new consultation in addition covers similar asset segregation rules for UCITS and also covers any uncertainty as to whether or not the rules relating to depositary delegates should also apply to central securities depositaries (“CSDs”) (there is a lack of clarity between certain recitals of UCITS V, its operating provisions and ESMA Q&As as to whether or not CSDs are considered to be delegates of a depositary in certain circumstances). The call for evidence closes on 23 September 2016 and ESMA will aim to finalise its work on asset segregation by the end of 2016.


A summary of the current regulatory development and potential issues

The Undertakings for Collective Investment in Transferable Securities Directive (UCITS) and its supporting Directives and Regulations, grant member states the ability to authorise collective investment undertakings, governed by a common set of rules, which can be marketed cross border to retail investors. The original Directive was enacted in 1985 with subsequent amendments in 2002 (UCITS III - note there was no UCITS II) replaced in 2009 (UCITS IV) and most recently amended (effective 18 March 2016) by UCITS V (Directive 2014/91 EU). UCITS account for around 75% of all collective investments by small investors in Europe.

For the most part UCITS V aligns with the AIFMD on remuneration and depositary requirements and additionally lays down a new framework on the application of sanctions for breaches of UCITS rules.

Three main areas are covered by UCITS V.

• A precise definition of the tasks and liabilities of all depositaries acting on behalf of a UCITS fund:

UCITS V seeks to harmonise national approaches across EU Member States to the role of the depositary by setting down uniform rules in relation to the depositary’s core safe-keeping and oversight duties. This includes, in particular, duties of cash
monitoring (including segregation of the assets of the fund from the depositary’s own assets) and a limitation of the entities at which cash accounts can be opened. Subject to a two year grandfathering period, only national central banks, EU-authorised credit institutions and any other category of institution that is subject to prudential regulation and ongoing supervision provided that it is subject to capital requirements (as well as to prudential and organisational requirements of the same effect as authorised credit institutions and investment firms) can act as depositary to UCITS.

The scope of the safe-keeping duties is dependent on asset type - the relevant criteria are whether assets are capable of being held in custody or not. If not, only a record-keeping and ownership verification duty applies (see additional details below).

The Directive restricts delegation of the depositary’s duties to the safe-keeping of the assets of the UCITS. The conditions under which the depositary may entrust its safe-keeping duties to a third-party correspond to those applicable under the AIFMD. In particular, delegation must be justified by objective reasons and be subject to strict requirements relating to the suitability of the sub-custodian. The depositary must exercise due diligence in selecting and appointing a sub-custodian and must monitor the sub-custodian’s activities on an ongoing basis. UCITS V also seeks to harmonise depositary liability standards to ensure a consistent level of investor protection throughout Member States. The Directive imposes strict liability for the loss of financial instruments held in custody: the depositary is obligated to return a financial instrument of an identical type or corresponding value, irrespective of fault or negligence of the depositary, unless the depositary can prove that the loss has arisen as a result of an external event ‘beyond its reasonable control.’ For all other losses, the depositary is liable if the losses result from the depositary’s negligence or intentional failure to fulfil its obligations. In contrast to the AIFMD, where, subject to certain conditions, liability can be contractually transferred to the sub-custodian, UCITS V requires that the depositary’s liability is not affected by a delegation of its safe-keeping function to a third party.

- Clear rules on the remuneration of UCITS managers:

The remuneration policy requirements directly replicate the corresponding provisions in the AIFMD and are supplemented by ESMA guidelines on sound remuneration policies. Under the Directive, management companies must establish and apply remuneration policies and practices that are consistent with and promote sound and effective risk management and that do not encourage excessive risk-taking that is inconsistent with the UCITS risk profile or constitutional documents. Policies should
be designed to prevent conflicts of interest and protect investor interests. The text
details a set of remuneration principles, including the treatment of fixed and variable
remuneration. The UCITS management company will also be required to disclose
the amount of remuneration for the financial year with appropriate detail in the
annual report of the UCITS fund. The management body should adopt the general
principles of the remuneration policy and be responsible for the implementation
and periodical review of these principles. The implementation of the remuneration
policy should be internally reviewed at least annually. Management companies who
are significant in terms of their size or the size of the UCITS that they manage are
required to set up a remuneration committee, which will be responsible for decisions
regarding remuneration, including those which have implications for the risk and risk
management of the management company or the UCITS concerned.

• A common approach to how core breaches of the UCITS legal framework
  are sanctioned:

The Directive sets out a list of the main breaches and also lay down the administrative
sanctions and measures that competent authorities should be empowered to apply in
the case of the main breaches. Under UCITS V, competent authorities will be required
to publish any sanction or measure imposed for the breach of national provisions.
The Directive also harmonises minimum administrative sanctions. The maximum
penalties can amount to €5 million (or 10% of annual turnover) for a company or
€5 million for individuals.

On 15 August 2016 an Implementing Regulation was published, which lays down
implementing technical standards with regard to standard procedures and forms for
submitting information regarding the above breaches to the European Securities and
Markets Authority (ESMA).

Implications for the funds industry

UCITS V addresses the role and liabilities of depositaries and the extent to which
they should be liable for assets held in custody, and for any third-party sub-custodian
they may appoint. Whereas previous versions of UCITS made the depositary liable
for unjustifiable failure to perform its obligation, UCITS V is stricter, defining that a
depositary is liable for all losses suffered as a result of the depositary’s negligence
or intentional failure to properly perform its obligations, and is responsible for the
actions of a sub-custodian.
7) General Data Protection Regulation
On April 27, 2016 the European Council, Commission, and Parliament jointly published the final version of the General Data Protection Regulation (GDPR), which will become legally binding in all EU Member States on May 25, 2018. The GDPR is roughly four times the length of its predecessor - the 1995 Data Protection Directive (95/46/EC) (DPD) and it replaces and contains almost twice as many recitals (interpretative clarifications).

Key takeaways:
The GDPR will apply to all companies (not just financial services firms) based in the European Economic Area (EEA), and to an increasing number beyond. Data collection and processing activities will be subject to the European regulation if such activities involve European Nationals' data and the ‘monitoring’ of European Nationals and/or involve European Nationals’ data and the ‘offering’ of goods and services in the EEA. Any company tracking European consumers or proactively offering goods/services in the EEA (factors such as a change of language and the choice of currency for payment processing being relevant) will have to comply with the requirements of the GDPR. The critical point is that the location of the controller and processor is no longer relevant.

• Changes in scope: The GDPR largely maintains the existing definition of personal data but it expands on the type of data used in the context of identifying individuals. What has also changed is that no longer does it have to be shown that data itself is specific to an individual’s identity (e.g. a personal ID number), but rather that it could be used in conjunction with other resources to derive it.

• Greater number of in-scope organisations: The GDPR, for the first time, will regulate data processors directly. Previously the data controllers were the only ones directly subject to the Data Protection Directive. An example of how this could have ramifications is in cloud computing where software services, platform services, and infrastructure services are provided by different organisations.

• Privacy by design and privacy by default: This is about minimising the use of personal data and reducing data risk where it is not disproportionately costly, essentially embedding the protection of personal data into the DNA of companies. Corporates will need to make privacy a central focus of their organisation and to build privacy in to every stage of the development of products and services.
• Breach notifications: The GDPR specifies that a breach must be reported to the Data Protection Authority (and in some cases the individuals impacted) within 72 hours of becoming aware of the breach when ‘... the controller becomes aware of a breach, which is likely to result in a risk for the rights and freedoms of individuals has occurred.’ Corporates need to put in place appropriate measures to comply with these tight notification timelines.

• With fines ranging up to 4% of global annual turnover, this is no longer a risk corporates and investors can afford to ignore.

Implications and issues to consider:
Although the GDPR is presented as a tightening of existing themes rather than a fundamental revision, it is hard to believe that it won’t have a significant impact on corporates. Corporates should continue to focus on compliance with the Regulation. Most companies outsource functions across their business, e.g., payroll, expenses and travel, data storage, and all of these will now have to be compliant with the new regulations.

Coupled with the significantly enhanced breach notification requirement and a sanctions regime with real teeth, we think privacy and data protection will be moving up the agenda of management teams.

Next steps: The GDPR takes effect on 25 May 2018. In the run up, guidance is being prepared by the Article 29 Working Party, ICO and other EU data protection authorities which the financial services industry is responding to.

U.S.

1) U.S. Regulatory Reform / Deregulation
One of the key questions on the minds of financial services firms and their clients is what the U.S regulatory landscape will look like under President Trump and there are two key developments we would like to highlight that give us an indication of the direction of travel.

The first development is the ‘The Financial Creating Hope and Opportunity for Investors, Consumers and Entrepreneurs (CHOICE) Act’, passed by the House on 8 June 2017, has significant implications for the financial services industry. The Act is split into seven sections, all of which deal with separate aspects of financial regulation. Some of the highlights include:
• Provide an “off-ramp” from the post-Dodd-Frank supervisory regime and Basel III capital and liquidity standards for banking organisations that choose to maintain high levels of capital. Any banking organization that makes a qualifying capital election but fails to maintain the specified non-risk weighted leverage ratio will lose its regulatory relief.

• Impose an across-the-board requirement that all financial regulators conduct a detailed cost-benefit analysis of all proposed regulations.

• Retroactively repeal the authority of the Financial Stability Oversight Council (FSOC) to designate firms as systemically important financial institutions (SIFIs).

• Repeal sections and titles of Dodd-Frank, including the Volcker Rule, that limit capital formation. Repeal Title II of Dodd-Frank and replace it with a new chapter of the Bankruptcy code designed to accommodate the failure of a large, complex financial institution. Repeal Title VIII of the Dodd-Frank Act, which gives the FSOC authority to designate certain payments and clearing organizations as systemically important “financial market utilities” (FMUs) with access to the Federal Reserve discount window, and retroactively repeal all previous FMU designations. Repeal Dodd-Frank’s so-called “Hotel California” provision (If an institution is deemed a SIFI, it is subject to heightened regulation).

• Increase the maximum criminal fines for individuals and firms that engage in insider trading and other corrupt practices.

The CHOICE Act will now move to the Senate, in which it has little chance of passing. The Senate seems inclined to pursue regulatory reform, but Senate Democrats and some Republicans have been openly critical of the CHOICE Act. The Senate will likely vote down the CHOICE Act and pursue an alternate course of amending financial regulation.

The second development relates to the report the Secretary of the Treasury Steve Mnuchin wrote to President Trump in June 2017 entitled “A Financial System That Creates Economic Opportunities: Banks and Credit Unions” in response to President Trump’s Executive Order detailing a set of principles that would guide the regulation of the U.S. financial system. This report covering the depository system is the first in a series of four reports from Secretary Mnuchin; subsequent reports will deal with capital markets, the asset management and insurance industries, and non-bank financial institutions. The expectation is that this report will set the direction of future regulatory travel in the U.S and has a far higher chance that it will be passed by the

Summary of the key recommendations for regulatory reform:
Addressing the U.S. Regulatory Structure

- Congress must take action to reduce fragmentation, overlap, and duplication in the U.S. regulatory structure and ensure that regulatory agencies work together to increase coordination.

- Congress should expand FSOC’s authority to play a larger role in the coordination and direction of regulatory and supervisory policies.

- Congress should reform the structure and mission of the Office of Financial Research to improve its effectiveness and to ensure greater accountability. Treasury recommends that the OFR become a functional part of Treasury.

Refining Capital, Liquidity, and Leverage Standards

- For the statutory, company-led annual Dodd-Frank Act stress test (DFAST), Treasury recommends raising the dollar threshold of participation to $50 billion from the current threshold of $10 billion in total assets. Treasury also supports giving the banking regulators the flexibility to implement a threshold for mandatory stress-testing that is tailored to business model, balance sheet, and organizational complexity such that institutions with assets greater than $50 billion could be exempt from stress-testing requirements.

- Treasury recommends eliminating the mid-year DFAST cycle and reducing the number of supervisory scenarios from three to two – the baseline and severely adverse scenario.

- The Fed should also revise the threshold for application of Comprehensive Capital Analysis and Review (CCAR) to match the revised threshold for application of the enhanced prudential standards, and the CCAR process should be adjusted to a two-year cycle.

- Treasury supports an off-ramp exemption for DFAST, CCAR, and certain other prudential standards for any bank that elects to maintain a sufficiently high level of capital, such as the 10% leverage ratio proposed by H.R. 10, the Financial CHOICE Act of 2017.
• The scope of application of the liquidity coverage ratio (LCR) should be considerably narrowed to include only internationally active banks.

• Treasury recommends delaying the domestic implementation of the Net Stable Funding Ratio (NSFR) and Fundamental Review of the Trading Book (FRTB) rules until they can be appropriately calibrated and assessed.

• Treasury recommends that the living will process be made a two year cycle rather than the current annual process.

Providing Credit to Fund Consumers and Businesses to Drive Economic Growth

• Treasury recommends recalibrating capital requirements that place an undue burden on individual loan asset classes, particularly for mid-sized and community financial institutions.

• A significant restructuring in the authority and execution of regulatory responsibilities by the Consumer Financial Protection Bureau (CFPB) is necessary: either the Director of the CFPB should be removable by the President, or restructuring CFPB as an independent multi-member commission.

Allowing Community Banks and Credit Unions to Thrive

• The capital regime for community banks having total assets less than $10 billion should be simplified, which can be achieved by providing for an exemption from the U.S. Basel III risk-based capital regime and, if required, an exemption from Dodd-Frank’s Collins Amendment.

• Treasury recommends raising the Small Bank Holding Company Policy Statement asset threshold from $1 billion to $2 billion.

• Treasury recommends changes to the CFPB’s ATR/QM rule and raising the total asset threshold for making Small Creditor QM loans from the current $2 billion to a higher asset threshold of between $5 and $10 billion to accommodate loans made and retained by a larger set of community financial institutions.

• For credit unions, Treasury recommends raising the scope of application for stress-testing requirements for federally-insured credit unions to $50 billion in assets.
Advancing American Interests and Global Competitiveness

- Treasury generally supports efforts to finalize remaining elements of the international reforms at the Basel Committee including establishing a global risk-based capital floor in order to promote a more level playing field for U.S. firms and to strengthen the capital adequacy of global banks, especially non-U.S. institutions that, in some cases, have significantly lower capital requirements.

Improving the Regulatory Engagement Model

- The role of the boards of directors (Boards) of banking organizations can be improved to enhance accountability by appropriately defining the Board’s role and responsibilities for regulatory oversight and governance.

Enhancing Use of Regulatory Cost-Benefit Analysis

- Treasury recommends that financial regulatory agencies perform and make available for public comment a cost-benefit analysis with respect to at least all “economically significant” proposed regulations; as such term is used in Executive Order 12866.

Encouraging Foreign Investment in the U.S. Banking System

- The application of U.S. enhanced prudential standards to foreign banking organisations (FBOs) should be based on their U.S. risk profile.

- Consistent with the thresholds recommended for U.S. BHCs, Treasury recommends that the threshold for IHCs to comply with U.S. CCAR be raised from the current $50 billion level to match the revised threshold for the application of enhanced prudential standards.

2) Securities infrastructure

a) Derivatives Reforms U.S.-EU equivalence

Cross border derivatives (which make up the majority of the derivatives market have been subject to rules on both sides of the Atlantic. In the U.S. for example these are enshrined in Dodd-Frank Title VII and in Europe they are covered by the European Markets Infrastructure Regulation (EMIR) which is covered in a separate section in this guide. Regulators on both side of the Atlantic have been working very closely on cross border derivatives with a view to aligning their respective rules in a way that conflict
of laws can be avoided. After three years of negotiation finally in February 2016 the European Commission and the Commodity Futures Trading Commission (CFTC) struck a deal for common standards for derivatives and for clearing houses.

As part of the agreement, the CFTC and the EU will each permit market participants to use one another’s central clearing counterparties (CCPs) to satisfy its derivatives clearing requirements. This accord is a big step forward towards global regulatory convergence.

More information can be found here: http://www.cftc.gov/PressRoom/PressReleases/cftc_euapproach021016

EMIR provides a mechanism for recognising CCPs and trade repositories based outside of the EU- in the U.S for example. Once recognised, EU and non-EU counterparties may use a non EU-based CCP to meet their clearing obligations and a non EU-based trade repository to report their transactions to.

The recognition is based on equivalence decisions adopted by the European Commission. These decisions confirm that the legal and supervisory framework for CCPs or trade repositories of a certain country is equivalent to the EU regime.

A CCP or trade repository established in this country can then apply to obtain EU recognition from ESMA. Once recognition has been granted, the CCP or trade repository can be used by market participants to clear OTC derivatives or report transactions as required by EMIR.

In addition to the equivalence of CCPs and trade repositories, the Commission can also develop equivalence decisions for other areas of EMIR, such as reporting, margins for uncleared derivatives and risk mitigation techniques, and non-EU trading venues.

From the U.S. side the CFTC has a substituted compliance framework. What this means is that foreign (e.g. EU) based CCPs register with the CFTC. If registered they must comply with the relevant U.S. requirements, including the CFTC regulations applicable to registered DCOs (derivative clearing organisations). Based on the Determination, DCO/CCPs may comply with certain CFTC requirements for financial resources, risk management, settlement procedures, and default rules and procedures (as set forth in the Determination) by complying with corresponding requirements under EMIR.
3) Taxation

a) IRS Section 385

A summary of the issue and current status
On 4 April 2016, the U.S. Treasury Department and the Internal Revenue Service (IRS) released proposed regulations (REG-108060-15) under Section 385 (the Proposed Regulations) that would treat certain intercompany debt as equity for U.S. federal tax purposes.

Key Points

**Basic Rule:** Related party debt will be treated as equity if it is: (i) distributed as a dividend on affiliate stock, (ii) used to purchase affiliate stock or (iii) used to purchase affiliate assets in a corporate reorganisation (i.e., the “per se” transactions). The three “per se” transactions are common tax planning transactions and are not limited to corporate inversion tax planning. In terms of definitions, debt includes all types of debt and related party debt means any debt between the U.S. tax consolidated group and a CFC and any debt between CFCs. Special rules apply to controlled partnerships.

**Funding Rule:** The Funding Rule is intended to prevent a taxpayer from avoiding the “per se” rules by separating the issuance of debt from a “per se” transaction. Related party debt issued within +/- 3 years of a transaction described by the Basic Rule is presumed to be equity. Exceptions for debt up to the amount of current E&P and for affiliate provided goods and services in the ordinary course are very limited and regulations include several anti-abuse rules.

**Documentation Rule:** Related party debt must also be adequately documented at issuance (akin to third party debt) and during its life or it will be re-characterized as equity for tax purposes. Related party debt means obligations in the “legal form” of debt. The Treasury has asked for comments on how these rules should apply to cash pooling, repos and similar obligations. Among other things, the proposed rules would require a borrower to memorialise its ability to repay related party debt at issuance (i.e., forecast, appraisal, etc.).

**Bifurcation Rule:** Historically the IRS could only treat obligations as debt or equity, an ‘all or nothing test’. Under the bifurcation rule the IRS can re-characterise debt as equity in whole or in part upon exam i.e. in applying substance over form principles upon review.

In terms of next steps, the comment period ended July 7, 2016 and industry commentators indicate that the Treasury will attempt to finalize the regulations in 2016,
given the upcoming change in government. At the same time the industry has asked for an extension of the comment period and is still awaiting feedback from the authorities.

The Documentation Rule will apply to newly issued debt when the regulations are made final. The Basic Rule will be effective when the regulations are made final. The funding rule applies to debt issued on or after April 4, 2016. It is important to note that the regulations provide a 90-day grace period to retire outstanding debt once the regulations are made final if that debt is re-characterised under the Basic Rule.

**Impacts and Issues to Consider**
The Proposed Regulations would have far-reaching consequences for corporates that issue debt instruments to related corporations and partnership and among the many concerns of global multi-national corporates related to the proposal is how it will impact cash pooling arrangements that are widely utilized.

Treasury departments could consider completing the following activities to equip themselves for a discussion with their tax advisors:

- Have a clear understanding of the scope and depth of intercompany lending throughout the enterprise, including documentation supporting the loans
- Document the rationale and process for intercompany funding to determine whether any activities could fall within the scope of the regulation
- Identify legal entities involved in the transactions and amounts being lent between them
- Document cash pooling structures for target balancing and notional pooling, noting instances where there are links between U.S./non-U.S. and non-U.S./non-U.S. entities

Simultaneously Treasury departments could also evaluate the potential to enhance centralised processes or polices to:

- Monitor and track lending and interest payments between entities
- Satisfy extensive documentation requirements
- Manage other “credit” related requirements
- Leverage alternative sources of funding besides intercompany

Finally, Treasury departments may wish to consider working with industry partners during the comment period to communicate the impact of the regulation.
LATIN AMERICA

1) Argentina

a) Economic / Financial Adjustments
Following the interventionist and unorthodox policymaking of former presidents Cristina Fernandez de Kirchner and Nestor Kirchner, the Macri Administration moved rapidly and taken a number of bold measures to course-correct the country. The economic policy adjustments passed early in Macri's term were centred on restoring investor confidence and include:

• Liberalizing currency controls
• Removing export tariffs
• Devaluing the peso
• Boosting central bank reserves
• Settling with the Holdouts
• Reducing subsidies, particularly on utilities
• Removing interest rate and fee caps on consumer lending and removing deposit rate floors
• Lowering reserve requirement for bank deposits in dollars
• Focusing on infrastructure projects and improving the framework for public-private partnerships
• Increasing revenue through a successful tax amnesty law

Managing the fiscal adjustment and lowering inflation have been, and continue to be, challenges for the government and the economy. More aggressive action on these is expected after the mid-term elections in October 2017.

b) Capital Markets Reform and Tax Reform
The government has also signalled its intent to move quickly on both capital markets reform and tax reform following the 2017 mid-term elections.
Capital Markets Reform
Argentina’s Securities and Exchange Commission (CNV) is working on a broader set of capital markets reforms with the goals of establishing a modern and transparent financial regulatory framework for the country’s economic development, increasing funding mechanisms available to companies and investors, and integrating the country’s markets. Parts of the reform may be implemented through executive order, while other parts will need to go through the Congress (particularly any provisions that have tax implications).

A preliminary understanding of the reforms suggests the following objectives:

- Strengthen the powers of the CNV as a regulatory body to set rates related to markets, clearing houses, derivatives registration bodies and other registered agents; enact norms designed to promote the transparency and integrity of the capital markets; evaluate and dictate regulations aimed at mitigating systemic risk. It also seeks to regulate the operation of derivatives transactions and registries, a priority for the financial industry.

- Create a regulatory framework for private banking (another priority for the industry) and modify the framework for mutual funds, including a review of the different types of investment instruments available, the types of assets in which the funds can invest, and the creation of special funds for qualified investors.

- Enable greater flexibility and more streamlined administrative procedures for issuers, including the issuance of negotiable obligations in foreign currency and the issuance of subordinated debt.

- Promote financial inclusion and greater access to the capital markets by small and medium sized companies.

Tax Reform
The government has also affirmed their intent to advance a tax reform in 2018. While there are currently few details about the specifics of a reform, most analysts expect the government to focus on simplifying the tax code and reducing the administrative burden to companies and individuals.

While the Macri administration develops its proposal, the Congress, through a bicameral committee, is also working to develop a set of tax policy recommendations to present to the government. The committee was formally installed in mid-2017 and has a year to produce its findings.
c) Anti-Money Laundering / Combatting Terrorist Financing Reform
Argentina’s Financial Intelligence Unit (UIF) updated the country’s AML framework in June 2017. The new regulations take a risk-based approach in line with international GAFI standards. Regulated entities are required to implement an AML/CTF prevention system that incorporates both risk management and compliance. It also requires entities to designate a Corporate Compliance office responsible for implementing AML/CTF programs, which includes the definition of risk tolerance and specific processes and procedures for clients deemed high risk. The regulations also address customer due diligence, including know your customer (KYC) identification requirements, transaction profiles, and periodic assessments. Finally, the regulations define reporting requirements for suspicious activity, large transactions, and international transfers, among others.

2) Brazil

a) Economic Reform Agenda
The Brazilian economy continues to face economic difficulties against the backdrop of political volatility and wide-spread corruption. Despite the challenges to President Michel Temer’s government, the economic team remains committed to an ambitious reform agenda, focusing both on macro and micro measures.

Labour
Brazil’s Congress passed a sweeping reform of the nation’s 1943 Consolidated Labour Code, in an ambitious effort to modernise the legislation.

The reform, lauded by the private sector, will help promote work flexibility and stimulate job creation. The reform is complex, with more than 100 changes to the original code, including many which fundamentally alter labour-management relations in Brazil, with executive compensation matters. One of the most important aspects of the law is the promotion of voluntary, out-of-court and collective bargaining solutions to labour problems - a key step to reducing labour litigation in the long run.

Pension
The Temer Administration is also trying to advance a structural reform that would help fix the broken Brazilian pension system, which has been registering consecutive deficits and is currently responsible for around 50% of the federal budget (estimated expenditure in 2017 is BRL 720B in pension system, versus BRL 100B in healthcare and BRL 40B in investments). The proposed amendment to the constitution has been under discussion in Congress since December 2016 and is pending passage in the Chamber and Senate floors. The bill seeks to increase the minimum retirement age to
65 for men and 62 for women (Brazilians currently retire on average at age 54 based on a formula that adds age and years of contribution paid into system).

Other changes involve the calculation of social security benefits; special retirement rules for civil servants, politicians and rural workers; and transition rules from the current system to the new.

Investors have placed significant importance on the government’s ability to pass this much needed reform, but movement will depend not only on the evolution of the political crisis, but on the government’s ability to negotiate with opposition lawmakers who believe the bill goes too far.

**Tax**

Finally, the recently proposed an amendment to the Constitution seeks to simplify the tax structure and reduce the administrative tax burden. Besides being complex, the current tax system presents high levels of tax evasion, overburdens the company’s payroll and stimulates fiscal wars between states. It is expected that the final version of the reform improves the efficiency of collection, with less bureaucracy.

In summary, the bill substitutes the PIS/Pasep (Social Integration and the Formation of the Public Servants’ Patrimony), ICMS (Tax on the Circulation of Goods and Services), ISS (Service Tax), IOF (Tax on Financial Transactions), Cide (Contribution of Intervention in the Economic Domain) and salário-educação for a value added tax, IVA - which has a selective extra rate for specific sectors like energy, transportation, electronics and automotive. Food products, drugs, machinery and equipment would be subject to tax relief. Besides reducing the wide variety of taxes, the simplification effort includes adoption of electronic tax collection, whereby the collected amount would be automatically remitted to the Treasury. The proposal establishes a 15-year transition period.

The reform proposal, opened for public consultation and partially supported by the Executive, is under discussion in a special committee of the House, its first step in the legislative process.

**Micro Reforms**

In addition to the structural reforms noted above, the government has embarked on a micro reform agenda that is creating significant value for the private sector, including passing a regulation that allows for outsourcing of core activities. They are currently working on improving the processes and attractiveness of massive concession projects and privatisations.
The government will sell off long-term concessions and controlling stakes in 57 properties. The list includes more than a dozen airports, 11 high-tension power transmission lines, 15 port terminals, a partial privatization of utilities holding company Elebrobras and various other assets, including highways, the National Mint and a federal lottery. The government hopes to promote R$44 billion in infrastructure investments from the sales, which will take place starting at the end of this year and extend throughout 2018.

b) Financial System Reform

Brazil’s Financial System Law (Bill 4595/1964) dates back to the 1960s and regulates both the industry and the Central Bank. Lawmakers have been working on a bill to modernize the Law and align it with existing piecemeal legislation already in place. The bill also seeks to: define that only the National Monetary Council may regulate, whenever necessary, the corresponding tariffs, commissions, terms and guarantees of financial institutions; improve the definition of a financial institution as a legal entity whose main activity is the remunerated loan of monetary resources raised by third parties, including custody. The modernisation would also seek to create a regulatory framework for FinTech that is sufficiently broad to allow for developments in technology, yet serve to protect and guarantee the solvency of the system.

The financial industry has several priorities for the bill:

- Retain the competence of the National Monetary Council to regulate interest rates, capital regimes, and other fees/commissions, as well as calculation methodologies;

- Have the Central Bank define a national standard for banking center hours of operation;

- Require impact and effectiveness assessments prior to the release of new financial regulations / standards;

- Elevate the security of branches and financial institutions as a national priority.

Lawmakers have been open to input from the industry and continue to refine the proposal. However, given the major legislative priorities tied to the economic reform agenda, the bill may not move this year.
3) Chile

a) Banking Modernisation Bill
Since June 2017, Chilean lawmakers have been debating the Banking Modernisation bill which is designed to strengthen the banking system via updates to the regulatory and resolution framework, as well as capital requirement increases. The measures are aimed at bringing the banking sector in line with international standards adopted following the financial crisis, as Chile moves towards Basel III implementation.

Part of that modernisation includes transferring the functions carried out by the Superintendency of Banks to the new Financial Markets Commission (CMF). Under the new commission, which was created through legislation earlier in the year, the regulator will receive new powers such as the jurisdiction to lift bank secrecy or to sanction the searching of premises with the purpose of investigating potential felonies. The transfer of functions is an effort to create efficiency that will allow the country to better respond to market challenges.

As for the Basel III, under the new bill the banking sector would be required to have sufficient capital to finance their business and strengthen their solvency in case of financial stress. These include increasing capital requirements for Tier 1 capital from 4.5% of risk-weighted assets (RWA) to 6% while keeping banks' effective equity at 8% of RWA, incorporating a capital conservation buffer of 2.5% of RWA, and an anti-cyclical cushion of 2.5% of RWA to protect the system during periods of credit expansion. Currently, the State guarantees repayment to citizens who deposit their money in financial institutions that later cannot return the deposited funds. Banks will have six years to comply with the new standards.

The House of Representatives Finance Committee unanimously approved the bill and is accepting suggestions for potential modifications until September 6, after which the committee will meet again to further review. With election campaigning now in full swing and several other bills pending review, it is possible that the Senate will not be able to review the bill until after the presidential elections.

b) Pension Reform
Chile’s system of individual contributions managed by private pension fund administrators (AFPs) was introduced in the 1980s. In her first term (2006-2010), President Michele Bachelet created a basic pension for the poorest financing by taxes. However, during her second Administration, President Bachelet’s government has faced significant pressure and protests by those unhappy with their retirement benefits.
Congress began debating a new pension proposal in August 2017 which includes the establishment of a new employer contribution rate of 5% of the employee’s monthly salary (in addition to the 10% currently paid by employees). Part of this incremental 5% would go to a public fund that would be administered by a state agency, a key area of controversy among policymakers. The agency would also seek to make changes to rules governing private pension fund administrators (AFPs). Given the strong opposition to some of these changes and the limited time remaining in President Bachelet’s term (March 2018), it is unlikely that the proposal will pass as is. Therefore addressing pension reform will continue to be a necessity for the next administration.

4) Colombia

a) Financial Conglomerates Law
As part of Colombia’s efforts to join the OECD and align with international standards, the Financial Conglomerates law was passed in August 2017 to create a more robust financial supervisory regime for the sector. It grants Colombia’s Financial Superintendency (SFC) broader supervisory functions over financial conglomerates (vs. individual entities) including:

- Determining the capital requirements of conglomerates
- Ordering changes in the structure of conglomerates
- Issuing instructions for risk management, internal controls, release of information, corporate governance and conflicts of interest
- Setting limits on risk exposure and concentration
- Visiting and requesting information from all entities belonging to the conglomerate, including holdings.

It also contains an exception for international banks that can demonstrate they are subject to compatible supervision. The law goes into effect in February 2018, providing companies with a six month transition period to make adjustments.

5) Data Privacy across Latin America
Several countries in Latin America are updating or proposing new data privacy frameworks, and similarities and differences can be drawn between the Latin American and European approach. Mexico, Argentina, Chile, and Colombia are taking a comprehensive approach to data privacy whereby any personal data is subject to regulation regardless of industry sector. This concept is similar to the European
model. However, in contrast to the EU there is no international or national body that regulates data protection in Latin America.

Following the passage of the Marco Civil da Internet (Law No. 12,965/2014), Brazil's so-called 'Internet Law', the focus of legislators has shifted to reconciling various data privacy bill proposals in Congress. While the provision to force companies to store all information regarding Brazilian users on local services was ultimately defeated in the Internet Law, problematic provisions related to companies' ability to process cross-border data flows continue to exist in the draft privacy bills. There are also broader concerns with provisions related to consent and fines. The private sector remains active in advocacy efforts to ensure the data privacy reform does not impact companies' abilities to innovate and serve customers, or hurt consumers' abilities to use digital products and services. Given the major legislative priorities tied to the economic reform agenda, it is unlikely that the data privacy bills are approved this year.

Colombia's Superintendency of Industry and Commerce has been working on a regulation related to international data transfers. The draft regulation would approve international transfers to countries on an approved list, effectively countries considered as having adequate and comparable data privacy frameworks. The original list of approved countries did not include the United States, but after a strong reaction by the U.S. private sector, the United States was added in the subsequent publication of the draft regulation. The private sector is also encouraging the SIC to consider other cross-border transfer mechanisms, like the APEC Cross-Border Data Privacy Rules or widely accepted concepts of standard contract clauses. Finally, additional clarifications are being sought for the definition of personal data and the use of de-identified or anonymised data.

6) Cybersecurity across Latin America
Most countries in Latin America are behind the curve in developing comprehensive and adequate cybersecurity strategies and legal frameworks. However, the topic has gained considerable attention in the last couple of years, and many countries are working to develop national cybersecurity strategies. The Organisation of American States (OAS) is supporting country efforts to develop the strategies, build local technical capacity, and increase awareness.

Brazil, Colombia, and Mexico are considered the most sophisticated in terms of cybersecurity capabilities and have taken proactive steps to develop national strategies. For example, the Colombian government approved a new national cybersecurity policy in 2016 to modernise the country's framework and capacity to prevent or respond to attacks on critical infrastructure and information. The policy
requires all Ministries to have risk management systems and adopt international best practices in digital security. It also seeks to safeguard freedom of expression, the free flow of information, and protection of personal data and privacy. Other objectives are to increase awareness of digital threats, build IT, law enforcement, and cyber defence capabilities, and make electronic transactions safer. The Colombian government has been open to private sector input, particularly in the financial sector.

In July 2017, the Mexican government, in collaboration with the OAS, launched its process to develop a national strategy which sets 2030 as the target to have Mexico well-positioned internationally in terms of cybersecurity and cyber resilience. The draft document, currently open to public consultation, also outlines additional objectives such as protecting data and e-commerce, spurring innovation, guaranteeing the reliability and safety of critical infrastructure, and strengthening international cooperation. The Mexican Securities and Exchange Commission (CNBV) is actively engaging the financial sector as part of the consultation process.

Smaller countries in Latin America and the Caribbean are also starting to pay greater attention to cybersecurity. The OAS has been partnering with the Dominican Republic, Panama, and Trinidad & Tobago, to name a few, on their own national strategies and capacity building exercises.

In Latin America as in other regions, information sharing mechanisms and international cooperation remain key priorities for the private sector when it comes to defending against cyber threats.

**ASIA**

1) **China RMB internationalisation**
Internationalisation of the RMB continues although restrictions on outflows have impacted the offshore RMB market. Restrictions on overuses Direct Investment by Chinese firms, especially high profile or contentious investments, might also impact. The architecture to facilitate internationalisation continues to expand.

There are now 15 RMB settlement centres globally: Australia, Canada, France, Germany, Hong Kong, Japan, Luxembourg, Macau, Malaysia, Russia, Singapore, South Korea, Switzerland, Taiwan and UK.

Following China’s National Party Conference (NPC) in March, the PBOC announced its support for the inclusion of Chinese onshore bonds into major international indices (including Citi’s emerging markets and regional government bond indices) and stated it is considering linking China’s bond markets with Hong Kong later this year as part of
continued RMB internationalisation efforts in a Bond Connect scheme. Restrictions on capital outflows appear to be easing.

On June 20, 2017, MSCI announced it would add 222 China A-shares in its emerging market indices, tracked by an estimated US$1.6 trillion, starting June 2018. This was the fourth annual review by MSCI into whether it should include China in its indices. The move could trigger an inflow of more than US$100 billion into China’s equities over the next five years.

On July 3, 2017, Bond Connect, a mutual bond market access programme between Hong Kong and Mainland China, was launched. A Northbound trading link was initially launched while a Southbound link will be added later.

2) RRP: Asia developments

A number of Asian countries have set out requirements that banks submit ‘living wills’ to relevant regulatory agencies that contain strategic analysis of how a distressed or failing institutions could be resolved in a way that does not pose systemic risk to the financial system. Domestically systemically important banks (D-SIBs) have also been designated in some markets if the entity is judged to post local systemic risk. Sometimes G-SIBs are designated but not always.

Singapore has issued a consultation paper on Tier 1 and Tier 2 capital that includes provisions allowing the Singapore MAS to write off or convert banks’ debt capital to equity prior to the failure of a bank. In addition, guidance on recovery and resolution, additional disclosures, effective risk data aggregation and reporting and the LCR have been issued. In June 2015 a further consultation on enhancement to the RRP was also issued by the MAS.

In April 2016, the MAS issued its Response to Feedback Received on the June 2015 Consultation Paper (“Response”), and an additional consultation paper on ‘Proposed Legislative Amendments to Enhance the Resolution Regime for Financial Institutions in Singapore’ (“April 2016 Consultation Paper”). On 8 May 2017, a bill setting out these amendments was moved for first reading in Parliament. The bill largely adopts the proposals from the 29 April 2016 consultation but also introduces a number of technical amendments that clarify and enhance the MAS’s existing resolution powers.

Hong Kong also issued a Supervisory Policy Manual on Recovery Planning in 2014. Banks selected in the first wave are required to submit their Recovery Plans within six months. Similarly to Singapore there are provisions for Basel III compliant debt capital that allow HKMA to write off or convert to equity prior to failure.
In May 2017, the Hong Kong Monetary Authority issued a briefing to the Legislative Council Panel on Financial Affairs, as part of an effort to ensure greater transparency and certainty on the actions that should be taken by banks. The briefing comments on proposed amendments to incorporate recovery planning provisions into Hong Kong's Banking Ordinance to fully reflect the standards set out in the 'Key Attributes of Effective Resolution Regimes for Financial Institutions' published by the FSB in October 2011.

**Malaysia:** Malaysian regulators (the Central Bank of Malaysia ("CBM") and the Malaysia Deposit Insurance Corporation ("PIDM")) are finalizing the framework for recovery planning and resolution planning. The CBM is the lead authority for recovery planning while PIDM is the lead authority for resolution planning. Selected financial institutions will participate in a pilot exercise based on a draft framework. Thereafter, the framework will be finalized for industry implementation in 2018-19. Based on the information provided to date, recovery plans will be developed and maintained by the financial institutions while resolution plans will be developed and maintained by PIDM.

### 3) Data On-shoring across Asia

Some countries in the region are requiring the on-shoring of data and limits on cross border transfers. This prevents firms using regional and global data centres and applications. In-country data centers are also expensive. Another requirement is for IT hardware and software to be sourced from domestic providers. Reasons range from concerns about privacy, security and access to data to a desire to build in-country Business Process Outsourcing (BPO) capabilities.

**Indonesia**

In Indonesia, legislation establishing requirements for on-shoring of data centers and data recovery centers was adopted in 2012 (Government Regulation No.82 on the Electronic System and Transactions) with implementation by October 2017. Industry hopes to achieve a delay in implementation or the possible removal of the mandatory on-shoring requirement. The ICT Minister has written to the President seeking a three year delay. A government group has also been formed to consider a delay or change to the on-shoring requirement with a decision expected by October 2017. Separately, the OJK (financial regulator) has introduced a data on-shoring regulation which may remain even if the law is changed.
China
There are implications for cross border data flows in China’s cybersecurity law that came into force in June 2017. The language about the security assessments to be carried out before personal information can be transferred outside the Chinese territory remains vague. There is also a risk that firms which use cloud-based servers, which host data outside China (including vendor functions used for internal administrative functions e.g. SAP, Concur, TalentQ), may be impacted if a firm is designated as a network operator. Note that there is a grace period for the requirements on cross border data transfers until December 2018.

Malaysia
Malaysia is a large data processing centre but is considering releasing regulations that prevent outsourcing outside of Malaysia. Such restrictions will impact firms seeking to use regional or global centers.

Implications for corporates
Corporates may be required to have data storage and processing facilities on-shore. In addition there may be restrictions on cross border data flows into regional and global and centers. There may also be limitations on the provision of IT hardware and software by foreign providers.

4) Cybersecurity
Managing cybersecurity issues is critical if the digitisation of financial services is to succeed. Governments and industry must work together to address cybersecurity risks. As economies in the APAC work towards realising the benefits of the digital economy, it is essential that cyber resilience frameworks are put in place.

While financial services firms have been proactive in developing cyber resilience measures, the integrity of any internal information security defence system will be more easily compromised if the external online environment enables cyber-crime to prevail.

The international business community is investing heavily in cybersecurity research and development. Regular exchanges between business and government are important to keep up with technological developments and to confront threats.

China’s cybersecurity law is a focus of attention. Key questions remain over which firms will be classified as a network operator and a key information infrastructure operator. Software and hardware from foreign providers may need to be substituted. Data on-shoring may also be required.
5) ASEAN Initiatives

Recent developments in ASEAN

This year marks 50 years since the formation of ASEAN and 40 years of U.S.-ASEAN relations. The U.S. signed the Treaty of Amity and Cooperation (TAC) in 2009 and was the first non-ASEAN country to establish a resident ambassador and permanent mission to the organisation. In 2015, the U.S.-ASEAN relationship was elevated into a strategic partnership and in 2016 the first multi-day U.S.-ASEAN Summit was held at Sunnylands, California, chaired by then-U.S. President Obama and a declaration on U.S.-ASEAN relations was issued. President Trump will attend the 2017 Head of State ASEAN Summit in November 2017.

On August 5, 2017, the Foreign Ministers of the Association of Southeast Asian Nations (ASEAN) met in Manila, The Philippines, for the annual ASEAN Foreign Ministers’ Meeting (AMM) under the theme of “Partnering for Change, Engaging the World”.

At the conclusion of their meeting, the ASEAN Foreign Ministers issued a 46-page joint communiqué touching on a wide range of subjects. Their commitment to the full implementation of ASEAN 2025, including the realisation of the ASEAN Economic Community (AEC) was reaffirmed.

The ASEAN Economic Community (AEC) was launched in late 2015 and sets out a roadmap to develop ASEAN into a regionally integrated and globally connected region by 2025. On trade and investment, the AMM noted the progress of the Regional Comprehensive Economic Partnership (RCEP) negotiations but the language did not suggest the trade agreement would be finalised this year as the Philippines, as ASEAN host, was hoping for.

An ASEAN Business travel card will also be explored. On financial services, the ministers welcomed the signing of an agreement between Qualified ASEAN Banks in Indonesia and Malaysia to facilitate intra-ASEAN trade and investment and the completion of negotiations between Malaysia and the Philippines under the ASEAN Banking Integration Framework (ABIF). A framework on Personal Data Protection and the ASEAN cybersecurity cooperation strategy which are being discussed were referred along with related initiatives. There were also references to e-commerce and the digital economy. MSMEs and entrepreneurship as well as women remain priorities along with rural development and poverty alleviation which may result in more priority sector lending.
6) Trade Agreements in APAC

**RCEP**
The 19th round of the Regional Comprehensive Economic Partnership (RCEP) negotiations took place July 17-28 in Hyderabad, India. RCEP is a proposed comprehensive regional economic integration agreement amongst the 10 members of the Association of South East Asian Nations (ASEAN) – Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam – and ASEAN’s six Free Trade Agreement (FTA) partners, Australia, New Zealand, Japan, China, Korea and India.

RCEP talks started in Phnom Pen, Cambodia, in November 2012. The 16 countries account for over a quarter of the world’s economy, estimated to be more than US$75 trillion. Only one further round of negotiations has been scheduled, which will take place in October 2017, and there remain 15 outstanding topics to be agreed to by all 16 players.

This makes it likely that the November 2017 ASEAN Leader’s Summit will have a RCEP statement of progress, with conclusion of negotiations likely to again be pushed out, rather than a concluded agreement. The Philippines as ASEAN host country had wanted to announce conclusion of the agreement this year. Some others had also hoped an agreement could be announced this year which celebrates 50 years since the establishment of ASEAN.

**TPP-11 (TPP minus the U.S.)**
TPP-11 may advance on the side-lines of the 21-country APEC Leaders Meeting in November 2017. Remaining countries are supportive of pressing ahead with the TPP after the many years of negotiations. The GDP requirement for entry into force will need to be revised to account for the U.S. withdrawal. A decision needs to be made on whether to open other sections. If that is done the risk is of protracted negotiations so entry into force may be the priority.

Bilateral trade agreements are being pursued by a range of countries including:

- U.S. - Japan (link to TPP)
- U.S. - Vietnam
- U.S. - Indonesia
- U.S. - Korea (upgrade)
• U.S. – China BIT (on hold)
• U.S. – India BIT
• Hong Kong – ASEAN
• Hong Kong – Australia
• Australia – Indonesia
• Australia – India
• EU – ASEAN
• EU – New Zealand
• EU – Indonesia
• EU – Thailand
• EU – Philippines
• New Zealand – India
• New Zealand – Russia
• Pacific Alliance – New Zealand
• Pacific Alliance – Australia

7) Trade Issues in APAC
Several APAC countries identified in a U.S. omnibus Bill due to trade deficits with the U.S. including China, Hong Kong, India, Indonesia, Japan, Malaysia, South Korea and Taiwan. Reports were submitted by governments, business associations and academics. The administration has not formally responded. Bilateral negotiations or trade actions may be pursued by the U.S.

Tension between the U.S. and China over economic issues particularly continuing trade imbalance in goods continues. The focus has been on steel, aluminium & semi-conductors, and reciprocal market access for U.S. firms.

50 & 100 day plans were issued and meeting of 4 pillars Comprehensive Economic Dialogue took place in July 2017. In August 2017, Trump issued a Presidential memo instructing USTR to consider investigating China on grounds of discriminatory
practices impacting US IP and innovation. A decision is unlikely until after the October/November leadership conference in China.

8) Bank Levy
Australia has proposed a bank levy on the top domestic institutions. The levy will apply to all authorised deposit-taking institutions that operate in South Australian and are liable for the Commonwealth Government major bank levy. These measures will effectively double the rate of the Commonwealth Government’s major bank levy, but only on the proportion of estimated liabilities in South Australia. Foreign institutions are exempt.

9) Trading & Markets Reform
• OTC derivative trade reporting is live in Australia, Hong Kong, Japan, and Singapore.
• OTC clearing is live in Australia, China, Hong Kong, India, Japan, and Korea.
• Margining of un-cleared swaps is live in Australia, Hong Kong, Japan, Korea, and Singapore.

10) Governance
Senior Managers’ In Charge Regime: The regime aims to provide more guidance on who should be regarded as the senior management of a licensed corporation and promote their regulatory obligations to heighten senior management accountability. The regime was implemented in April 2017 in Hong Kong. Australia has also started to look at implementing a similar Bank Executive Accountability Regime.

11) Payment Gateways
Vietnam is considering routing payments through a domestic gateway run by a state owned entity (NAPAS) under the central bank. Indonesia is also considering routing payments through a domestic gateway run by a consortium of local banks and a state owned entity.

A consultation was released in August 2017 which would require international cards companies like Visa/MasterCard to apply for new licenses to participate in domestic payments and to reduce from 100% ownership to a minority JV of around only 20%. Possible privacy/security/operational risks, reduced efficiency/competitiveness of foreign EPS providers and increased costs are concerning.
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