Q1 Regulatory Update

Agenda

- Update on the UK General Election and French Presidential Election
- Securitisation Regulation
- MiFID II
- Upcoming events

Update on the UK General Election and French Presidential Election

Jiří Król

UK General Election

- Snap General Election called for 8 June
- Pretty much a single issue election focused on Brexit
- Conservative Party holds a commanding lead over Labour in the opinion polls, a rare phenomenon for a governing party
- The Conservative Party currently has a slim working majority in the House of Commons – opinion polls currently suggest that Mrs May could significantly increase this number

Brexit: likely manifesto commitments

AIMA

Conservative	Labour	Liberal Democrats	Scottish National Party
▪ Withdraw from the Single Market and Customs Union ▪ End to free movement of EU citizens ▪ Comprehensive new trade deal with the EU ▪ Separate trade deals with non-EU countries ▪ New immigration policy for EU and non-EU nationals	▪ Access to the benefits of the Single Market ▪ End to free movement of people ▪ Rights of EU nationals in the UK to be guaranteed from day one, without a reciprocal deal for UK nationals in the EU ▪ Workers' rights, environmental standards and consumer rights to be protected	▪ Protect existing aspects of EU membership, including access to the Single Market and free movement of people ▪ Second referendum on the final terms of any deal struck between the UK and EU	▪ Scotland to have a 'special status' after Brexit, including the right to remain in the Single Market and Customs Union ▪ Continued free movement of people ▪ Second Scottish independence referendum before the final Brexit deal has been approved by Parliament

What does this mean for Brexit?

AIMA

May accuses Brussels of trying to influence UK election

Prime minister says EU politicians are making 'threats against Britain'

Davis says Brussels cannot set Brexit rules

Brexit secretary says UK is not a supplicant in negotiations

Brussels hoists gross Brexit 'bill' to €100bn

France and Germany back tougher approach to Britain's departure obligations

UK's financial obligations to EU will be 'incontestable', says Barnier

EU's chief negotiator says: 'Commitments have been made and those responsibilities have to be honoured'

Potential complications

- Voter fatigue - third nationwide poll in as many years
- Conservative voter complacency, given the Party's commanding lead in the opinion polls
- Tactical voting: e.g. pro-Brexit parties are not fielding candidates against incumbents who voted to leave the EU, or where a pro-Brexit candidate is likely to remove a pro-Remain MP
- If a clear majority is not won by the Conservative Party, could the opposition parties form a coalition government or 'progressive alliance'?

Impact on financial services industry

AIMA

- Financial services clearly not the most favoured sector by the current Conservative Party leadership (remember the “citizens of nowhere” speech)
- Fishing in UKIP waters brings a greater likelihood of an electoral victory and long term Conservative government, but uncertainty as to the ‘best possible outcome’ for the Brexit negotiations
- Using Brexit for internal electoral campaign when negotiations have already started could backfire by hardening public opinion and creating a sense of threat/siege
- ‘Clean’ Brexit with limited single market access could become the optimistic scenario!
- Greatest risk: a disinterested government when it comes to internal financial services policy and a government that will result in a disruptive exit from the EU

French Presidential Election

- French voters rejected the two main political parties in the first round of voting – full 75% of voters opted for ‘anti-establishment’ or new party candidates
- Macron won Sunday’s vote with a relatively strong margin but that is mainly because of anti-Le Pen voting rather than positive support for his programme (got only around 25% of the vote in the first round)

Macron’s policies

- Macron’s vision for France – centre all the way:
  - Budget savings of €60bn to bring France in line with the EU deficit limit of 3% of GDP
  - Public investments worth €50bn over five years for environmental measures, apprenticeships and public infrastructure
  - Lower corporation tax to 25% (currently 33.3%)
  - Reduce social security contributions and introduce flexibility on the 35-hour working week rule
  - EU reform: give the Eurozone a separate budget, finance minister and parliament
  - EU Single Market rules should apply fully to all trade partners
  - Promote free trade deals – but with greater input from affected stakeholders

Challenges for Macron

- Prime Minister and government appointed on the basis of a parliamentary majority
- En Marche! has no MPs in the French Parliament, so the party will need to perform well in the legislative elections on 11 and 18 June
- Broadly 4 blocs will compete in the elections – the Left (mainly the Socialist party), the social/liberal Centre (En Marche), the Right (Les Republicains - LR) and the Far Right (Front National - FN).
- Latest polls show that no party likely to get the necessary majority of 289 seats
  - En Marche! 249-286
  - LR / Other centre right: 200-210
  - PS / Other left: 34-50
  - FN: 15-25
- Very real prospect of a coalition – hasn't happened in France since 1958
- Germany not quite on board with his EU reform agenda

Impact on financial services

- Macron ‘gets it’ when it comes to financial services – more so than any other of the presidential candidates
- Nicknamed ‘*Mozart de la Finance*’
- Knowledgeable about capital markets, hedge funds and private equity/credit managers
- BUT!!! France competing to become the capital markets capital of the EU – Macron a self-described “hard Brexiteer”
- Macron is a “Euro-federalist” – wants to re-launch the EU project and establish sovereignty at EU level – critique of Brexit – national level sovereignty is the wrong kind – EU must protect against unfair competition and guard against special deals
- Financial services likely to top the agenda for Brexit negotiation – in that regard, there’s little change in comparison to the previous government
- UK likely to see itself either locked out of the EU markets or becoming a rule/supervision taker for all intents and purposes

Conclusion

- UK and French elections are contributing to further polarisation of positions as regards Brexit
- UK: Conservative Party aiming to attract UKIP electorate in Labour areas – the 'no deal better than bad deal' slogan could get more support (May conscious she won't be able to repeat Cameron's renegotiation mistake)
- FR: A pro-EU President who wishes for more united Europe with a stronger internal market around the Eurozone and the end to the 'neo-liberal' order
- The key to successful negotiations will be the extent to which respective leaders are able to manage their more radical allies
- The elections, rather than moving the expected negotiation outcome one way or another (harder vs softer Brexit), are likely to create a wider dispersion of potential outcomes – a "no deal" scenario is becoming more likely

Securitisation Regulation

Marie-Adelaide de Nicolay
Nicholas Smith

Background

- As part of the CMU action plan, the European Commission proposed two legislative measures to promote a safe and liquid market for securitisation:
  - **A regulation on securitisation** that will apply to all securitisation products and include due diligence, risk retention and transparency rules together with a clear set of criteria to identify simple, transparent and standardised (STS) securitisations
  - **An amendment to the regulation on capital requirements** to make the capital treatment of securitisations for banks and investment firms more risk-sensitive and able to properly reflect the specific features of STS securitisations
- These measures are intended to:
  1. restart markets on a more sustainable basis, so that simple, transparent and standardised securitisation can act as an effective funding channel to the economy
  2. allow for efficient and effective risk transfers to a broad set of institutional investors as well as banks
  3. allow securitisation to function as an effective funding mechanism for some longer term investors as well as banks
  4. protect investors and manage systemic risk by avoiding a recurrence of the flawed "originate-to-distribute" models

Political state of play

- The file is currently in trilogue - the process by which the EU Parliament, the EU Commission and the EU Council consider the legislation and agree the final text
- The Parliament previously prepared amendments to the regulation that departed from the Commission and Council text in a number of key areas:
  - Risk retention requirements
  - Institutional investors definition and scope
  - Transparency on investors' ultimate beneficiary
  - The retroactive applicability of the requirements
- Whilst all three parties have expressed a strong desire to finalise the securitisation during the current Maltese Presidency (which ends 30 June 2017), there are still some key fault lines in their respective positions, particularly on these key issues
- The most recent trilogue discussions saw the Commission provide compromise solutions which put forward some encouraging proposals, but the Parliament has not, so far, formally moved from some of its most aggressive positions
- This file was also subject to comments from Vice-President Dombrovskis during a recent public hearing on the CMU where he remarked on the urgent need to finalise this file

Political state of play

Topic	Commission	EU Council	EU Parliament	Implications for AIFMs
Risk retention	5% risk retention rate for four methodologies	Same requirements as the Commission	Increase risk retention rate to 10% for vertical slice retention and certain other types of retention	Many CLO managers who operate with vertical slice retention will face a dramatic increase of costs
Sponsor definition	No mention of AIFMs. 'Sponsor' means a credit institution or CRR investment firm	Same definition than the Commission, with the additional possibility to delegate portfolio management to an authorised AIFM	Same definition as the Commission	Neither AIFMs nor non-CRR investment firms will be able to be a sponsor of a securitisation scheme. Non-EU entities will also be excluded
Institutional investor definition	'Institutional investor' includes AIFMs which manage and/or market AIFs in the EU	Same definition as the Commission	Removes the reference to manage and/or market AIFs in the EU	Non-EU AIFMs marketing their AIFs in the EU under the available national private placement regimes will be caught by the EU Parliament definition and will have to comply with the Regulation's requirements on all their clients accounts not just the AIFs being marketed in the EU
Transparency on ultimate beneficiary owner	n/a	n/a	The investor in securitisation on the secondary market must make available information on the ultimate beneficial owner	Transparency on ultimate beneficial owner will be required, despite potential conflicts with existing contractual arrangements and/or statutory rules on confidentiality

Political state of play

Topic	Commission	EU Council	EU Parliament	Implications for AIFMs
Parties to the securitisation market	n/a	n/a	Additional article allowing only investors submitted to ”equivalent” regulations to the one applicable in the EU to participate in the securitisation market	Non-EU investors will have to be subject to regulations that are deemed “equivalent” to the ones applicable to institutional investors in the EU to be able to buy EU securitisations (not limited to STS)
SSPE domiciliation	n/a	n/a	Additional article setting a whole list of criteria for SSPE domiciliation	Many offshore jurisdictions will no longer be available to SSPEs
Retroactive effect	Retroactive due diligence requirements on securitisation issued before 2011 where new underlying exposure have been added after 31 December 2014	Applicability of CRR due diligence requirements until the entry into force of the Securitisation Regulation	Same position as the Council	This provision would apply to non EU AIFMs and subthreshold AIFMs which until now are exempt from due diligence under the AIFMD

Key AIMA positions

- **Risk retention:** Keep the Council and Commission position : risk retention levels should not be raised above 5%
- **Sponsor definition:** AIFMs managing CLOs should be permitted as eligible “sponsors”
- **Institutional Investor definition:** Limit the definition to *authorised* so as to carve out non-EU AIFMs/sub-threshold AIFMs from the “institutional investor” definition. Not doing so extends the scope beyond Section 17 of AIFMD
- **Ultimate beneficial owners:** Delete this EP amendment - investors should not be required to disclose their ultimate beneficial owners
- **Parties to the securitisation market:** Delete this EP amendment - non-EU investors should be allowed to invest in EU securitisation
- **SSPE domiciliation**: any restrictions to SSPE domiciliation should refer only to the Financial Action Task Force (FATF) list
- **Retroactive effect:** Transitional periods should be looked at carefully and non-EU AIFMs/sub-threshold AIFMs should be carved out of the retroactive due diligence requirements. Not doing so extends the scope beyond Section 17 of AIFMD

Next steps

- The next political trilogue will take place in Strasbourg on 16 May
- AIMA has recently submitted our comments on the latest compromise text to the Maltese Presidency and other key stakeholders and will be following this up bilaterally with key individuals
- AIMA will discuss current progress on the Securitisation Regulation with the Malta Financial Services Authority on 18 May

MiFID II

Adam Jacobs-Dean

Where are we?

- Go-live: 3 January 2018
- ESMA continues to release Q&A – April update included new questions on corporate access
- First FCA Policy Statement (PS17/5) published in March covering markets issues. Further PS expected end of June
- FCA industry roundtables continue; AIMA also meeting individually with FCA policy contacts on a range of issues (to-date: best ex; taping; research)

Live discussion points

- Scope of the telephone taping obligation: at what point should a telephone conversation be seen as "relating to" execution? What about face-to-face conversations?
- Which services fall within the scope of the ban on inducements?
- Does MiFID2 apply to a non-EU firm when it acts as a subadvisor to an EU firm?
- What are the implications for US broker-dealers if European clients need to pay for research using P&L or RPA amount, i.e. "hard dollars"?
- Under what circumstances can an EU manager use investment research obtained by non-EU affiliates through non-MiFID-compliant payment models?
- What are the operational advantages and disadvantage of ring-fencing MiFID2 to your EU operations?
- Will investor pressure drive global convergence around MiFID2 standards, particularly in respect of best execution and payment for research?

Delegation

- Consider a situation where an EU investment manager delegates portfolio management to a US affiliate. Question: to what extent does the US delegate have to conform to MiFID2 requirements, including on payment for research?

- Article 31(1) of the MiFID2 Delegated Regulation establishes that "[i]nvestment firms outsourcing critical or important operational functions shall remain fully responsible for discharging all of their obligations under Directive 2014/65/EU."

- March 2017 FCA statement on firms' use of dealing commissions:

  "We were concerned to see that some firms with overseas operations and those that delegated investment management services failed to implement controls and oversight structures to ensure the activities they outsourced complied with our rules. Firms which operate 'global' commission models must meet our requirements on their investment management activities that take place in the UK, including COBS 11.6."

- AIMA's view: delegation doesn't create a positive requirement on the part of the delegate to comply with MiFID2 standards – see April 2017 letter to FCA

AIMA resources


AIMA

MiFID2

A Guide for Investment Managers

February 2017

Sponsored by

Schulte Roth & Zabel


AIMA

MiFID2

Vendor List

April 2017

Current work streams

- AIMA member survey live – will provide firms with benchmarks against which to assess their own commercial and strategic decision-making

- Working with AFME on:

  - guidance on the treatment of consultancy and cap intro for the purposes of the inducements provisions;

  - potential questionnaire to brokers to provide a consolidated view of broker offerings

- Exploring potential to develop standard terms or checklist for review of updated execution agreements

- Bloomberg/Clifford Chance webinar on repapering on 22 May 2017

Upcoming events

16 May, London - Navigating Private Placement Regimes

6 June, Washington D.C. - 'Lending for Growth' ACC workshop – SEC Commissioner Michael Piwowar will discuss the role of non-bank finance in supporting the US economy

7 June, New York – Spotlight USA

8 June, Tokyo – AIMA Japan Annual Forum

4 July, London – Next Generation Manager Forum

Please visit https://www.aima.org/events.html to register

Contact

Tel: +44 (0)20 7822 8380

Email: info@aima.org

Web: www.aima.org