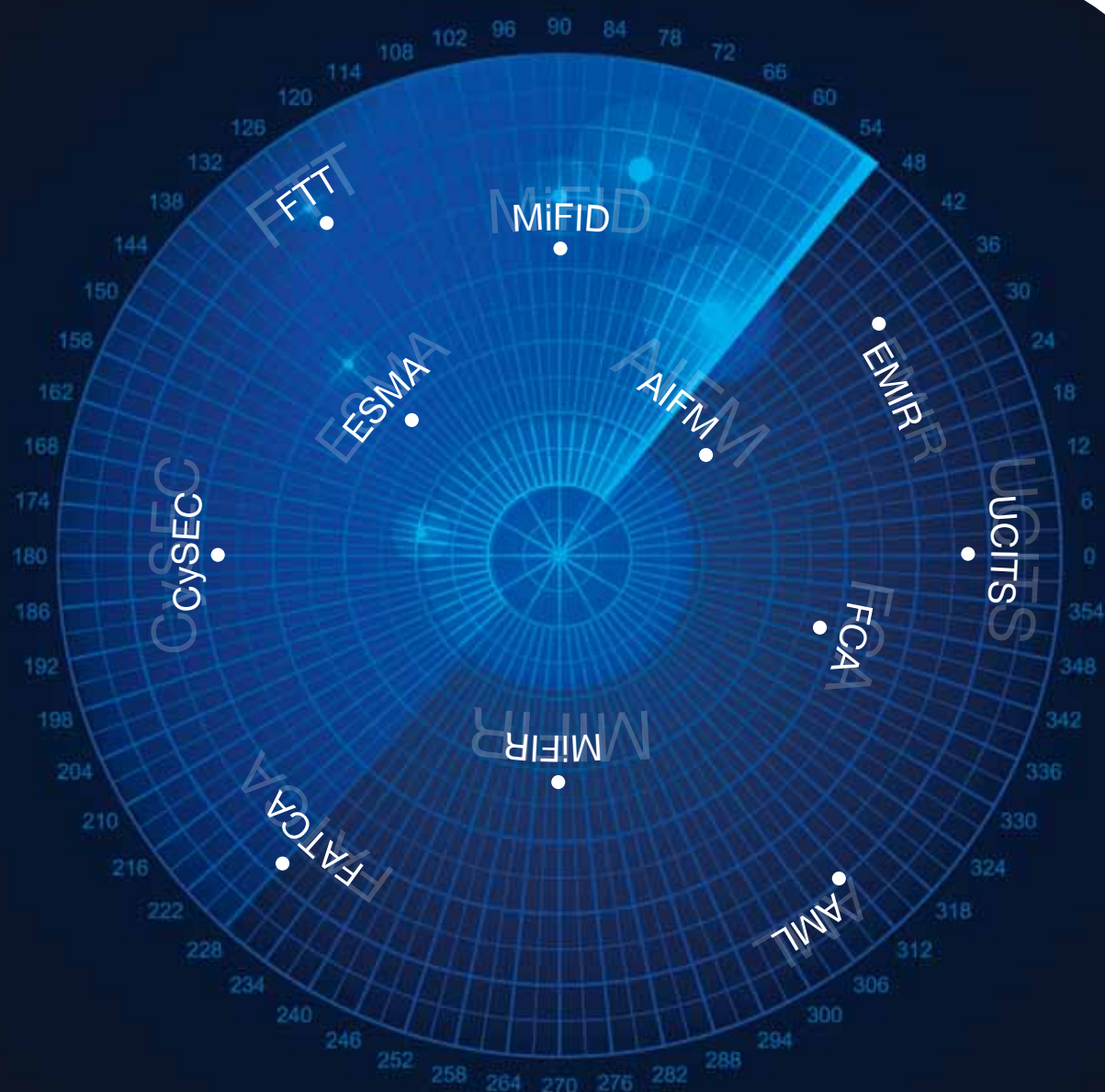


# REGULATORY RADAR

Periodical round-up on major regulatory and legislative developments in the EU and Cypriot financial services sector





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# 60 Second Summary

## 1. Developments in the EU Financial Services Legislation Affecting Investment Firms

### • MiFID II

The revised directive and accompanying regulation was agreed by the European Parliament in April 2014; final texts published on 12 July 2014; new rules come into force on 3 January 2017 (30 month implementation timetable); consultation on the Level 2 legislation has begun

### • EMIR

Staggered implementation continues: 11 August 2014 is the start date for reporting valuation & collateral; ESMA launched consultations on 11 July 2014 to determine eligibility for clearing of certain IRS and CDS; the clearing obligation for standardised OTC derivatives is estimated to come into force in Q2 2015 for clearing members and 12 months later for non-clearing members; ESMA's consultation on margin for non-cleared OTC derivatives indicates that initial margin will not be mandatory for certain types of FX transactions (variation margin will apply)

### • Other

- The new Market Abuse Regulation was finalised (in effect as of 3 July 2016)
- T+2 settlement from 1 January 2015 for EU securities pursuant to the Central Securities Depository Regulation. Some EU securities markets will switch to T+2 from 6 October 2014
- Securities Financing Transactions proposal – reporting of stock lending and repos to trade repositories and certain disclosures to be made to fund investors

## 2. Anti-Money Laundering

- The draft Fourth Anti-Money Laundering Directive and the draft Funds Transfers Regulation are still being finalised

## 3. Regulatory Developments in the European FX Industry

- The Commission stated on 23 July 2014 that it would be unable to clarify the delineation of MiFID FX financial instruments vs spot FX contracts by way of an amendment to MiFID I; the issue will be dealt with in MiFID II level 2 measures and ESMA may take some interim measures to provide the market with some certainty
- The thematic review of the UK's FCA into best execution practices has already resulted in sanctions against one FX trading firm for breach of best execution rules; its findings were published on 31 July 2014: most firms are not doing enough to deliver best execution

## 4. EU Financial Transaction Tax

- No real progress; no detail; no timeline
- EU Presidency and FTT participating Member States issue token statements prior to the European Parliament elections

## 5. FATCA

- Cyprus–US Inter Governmental Agreement treated as “in-effect”; Cypriot Financial Institutions have until 31 December 2014 to register with US IRS

## 6. Fund Regulation

- The transition period for compliance with AIFMD expired on 22 July 2014
- MIFID II clarifies that AIFMs will be able to passport certain restricted MIFID services permitted under AIFMD (as of 3 July 2015)
- UCITS V agreed by European Parliament in April 2014
- Money Market Funds legislation; work still in progress

## 7. EU Bank Recovery and Resolution Directive

- BRRD agreed by the European Parliament in April 2014; the Commission consulted in July on funding for resolution funds

## 8. CySEC Developments

- Issuance of circular re the registration of AIFMs who do not exceed the prescribed threshold; deadline for registration expired
- Update of Public Register of Certified Persons
- Issuance of consultation paper re credit given to retail investors for margin trading on securities listed on the Cyprus and Athens stock exchanges
- Issuance of circular to inform CIFs about the adoption by the European Parliament and the Council of the BRRD
- Issuance of consultation paper re CySEC's upcoming Directives on Alternative Investment Funds
- Issuance of circular for updates to the legislation of capital adequacy and large exposures for CIFs; CySEC addresses issues re the promptness of submission of the relevant capital adequacy info, stricter compliance with capital adequacy obligations/limits and about intention to adopt new COREP forms
- Issuance of circular re weakness identified and upcoming changes in CIFs' supervisory functions (incl. Board of Directors), governance arrangements and risk management requirements
- Issuance of announcement to inform CIFs about the press release of the European Commission regarding its legislative proposal to regulate Money Market Funds
- New Alternative Investment Funds Law voted replacing the ICIS Law; Supervision of AIFs is now transferred from the Cyprus Central Bank to CySEC
- Issuance of consultation paper re upcoming Directive for Tied Agents; the upcoming Directive shall specify procedures for the registration of Tied Agents, the notification to CySEC to appoint a Tied Agent and the disclosure of info that need to be made when cooperating with Tied Agents
- CySEC requests the view of certain CIFs on the implications that a possible removal of Russia from the list of equivalent third countries for CRD purposes will have on their capital adequacy and large exposures

# European Institutions Update

## European Parliament

The European Parliamentary elections in May gave rise to a pre-election rush in mid-April to push through priority dossiers (including MiFID II, BRRD, CSDR, UCITS V and Banking Union) followed by a subsequent “lock-down” of legislative work. The new European Parliament and Parliamentary committees are currently taking shape. Realistically, legislative work will resume after the summer recess. However, both the Council and the European Supervisory Authorities (e.g. the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA)) continue their work. Dossiers can be debated afresh by the new MEPs; they will not necessarily accept the pre-elections’ positions.

## Council of the EU

Italy took over the Presidency of the EU Council from Greece on 1 July 2014. The Italian Presidency’s “Europe, a fresh start” agenda, outlines its goals for the next six months.

## The European Commission

A new Commission is taking shape. Jean-Claude Juncker has been appointed as Commission President taking office in November 2014; the 28 Commissioners are being selected.

# 1. Developments in the EU Financial Services Legislation Affecting Investment Firms

## I. MiFID II

The MiFID II legislative proposal consisting of an amending Directive (MiFID II) and a new regulation (the Markets in Financial Instruments Regulation = MiFIR), were approved by the European Parliament in plenary session on 15 April 2014 and adopted by the Council of the EU on 13 May 2014. The final texts of [MiFID II](#) and [MiFIR](#) were published in the Official Journal on **12 June 2014**. These texts are often referred to as the “Level 1” texts; further detail is provided in subsequent secondary legislation often referred to as “Level 2” text.

National transposition is required by **3 July 2016**; the new rules will apply from **3 January 2017**. This is a 30 month implementation rather than the 24 months which the Commission wanted. The new Market Abuse Regulation (MAR) will apply from **3 July 2016**.

## Secondary legislation (known as “Level 2 measures”)

MiFID II/MiFIR contains over 100 requirements for ESMA to draft Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) (“technical standards” are drafted by ESMA and approved by the European Commission; they are to be provided by mid-2015), and to provide Technical Advice to the European

Commission, to allow it to adopt delegated acts (“delegated acts” are drafted by the European Commission on the basis of advice from ESMA; the Technical Advice is to be provided by end 2014).

On 22 May 2014, ESMA published the following documents:

- a) Consultation Paper on MiFID/MiFIR Technical Advice – ESMA needs to deliver this advice to the European Commission by December 2014 and is therefore subject to a condensed consultation process for this paper; and
- b) Discussion Paper on MiFID/MiFIR draft RTS/ITS – this will provide the basis for a further consultation paper on the draft RTS/ITS which is expected to be issued in late 2014/early 2015.

The closing date for responses to both papers was on **Friday 1 August 2014**.

## **High level preliminary analysis of MiFID II and MiFIR Level 1**

MiFID II introduces significant changes in the following main areas:

- Scope
- Market structure
- Investor protection
- Third country access

## **Scope (expanded)**

MiFID II/MiFIR extends the scope of the existing Directive (MiFID) by:

- extending the definition of investment services: creating a new MiFID investment service of operating an organised trading facility (OTF)
- extending the definition of financial instruments: creating new financial instruments including emissions allowances
- restricting certain MiFID exemptions: thus bringing more firms within scope

## **Markets (further regulation and increased transparency)**

- Creation of a new category of trading venue – the Organised Trading Facility (OTF)
- Measures to push more trading onto regulated trading venues – Regulated Markets (RMs) Multilateral Trading Facilities (MTFs) and OTFs – and Systematic Internalisers (SIs)
- Significant extension of the pre- and post-trade transparency regimes to a wider range of equity and non-equity instruments
- Measures to promote access to clearing facilities
- Algorithmic trading and direct market access subject to detailed requirements
- Derivatives trading obligation for OTC derivatives subject to the clearing obligation under EMIR
- Transaction reporting extended



## Investor protections (enhanced)

- Greater protection for municipalities and public authorities
- Enhanced suitability and appropriateness requirements
- Enhanced information requirements for clients
- Enhanced best execution requirements for clients: investment firms will be required to make better disclosure to clients and make public, for each class of financial instrument, the top five execution venues where they executed client orders in the preceding year, on an annual basis
- Enhanced conflicts of interest rules
- Product governance procedures for product manufacturers
- Firms providing advice will have to inform clients whether the advice is provided on an independent basis or not
- More limited range of financial instruments for 'execution only' i.e. "non-complex financial instruments"
- Ban on inducements, when providing independent advice or portfolio management services; the receipt of fees, commissions or any non-monetary benefits by investment firms will be prohibited
- Transparency on bundled services (e.g. execution and research) which must be unbundled and separately priced
- ESMA, EBA and home state regulators will have product intervention powers
- Enhanced governance requirements for investment firms in terms of management body constitution

## Third countries (tightening up)

- Branch regime: Member States may require third country investment firms to establish local branches, in order to be able to provide services to retail clients and clients who request to be treated as professional clients (including individual investors, public sector bodies, local public authorities and municipalities)
- Licensing regime: For direct access to EU eligible counterparties and per se professional clients, third country investment firms will need to be licenced. Licensing will be subject to Commission decisions on equivalence – application and registration will be with ESMA
- Where a third country investment firm establishes a branch, such firm may offer services across the EU from that EU branch (under a passport)
- The new third country regime, does not prevent retail clients and clients who request to be treated as professional clients and are established or situated in the EU, from receiving services from a third country firm (i.e. a firm outside the EU), which the client has initiated at is "own exclusive initiative". This is sometimes referred to as "reverse enquiry", "reverse solicitation" or "own initiative"

## ESMA Retail Investor Guide to MiFID II

ESMA has published a [short guide](#) for retail investors explaining the impact of the changes to be made, in investor protection under the MiFID II reform. It highlights some of the more important changes to MiFID, which may be most relevant to retail investors.



### Scope - FX spot contracts

In view of differing interpretations in Member States of an FX Forward transaction, the Commission launched a [consultation](#) seeking stakeholders' views on where the boundary between an FX financial instrument (i.e. an FX Forward) and a spot FX contract should be set. The consultation closed on 9 May 2014 and a Commission Regulation clarifying the definition of foreign exchange derivative contract was expected in Q3 2014. In the interim, national regulators were to apply their own interpretations. The FCA has stated orally that FX spot under 7 days is not within scope of MiFID and therefore EMIR; however, some market participants are applying a conservative T+3 cut-off.

On 23 July 2014, the Commission wrote a [letter](#) to ESMA, explaining that there was no longer any legal mechanism available to address the issue by way of an amendment to MiFID I. The Commission accepted that the issue nevertheless needed resolution and suggested that the definition of an FX contract should be dealt with in the MiFID II Level 2 measures. Recognising that such measures will not come into effect until 3 January 2017, the Commission leaves it to ESMA to determine whether there is a sufficiently harmonised position across Member States or whether further measures by ESMA are required e.g. guidelines.

The Commission also provides the feedback from its consultation setting out that there was a broad consensus on using the following lines to define FX spot contracts:

- To use a T+2 settlement period to define FX spot contracts for European and other major currency pairs (Euro, Croatian kuna, Bulgarian lev, Czech koruna, Danish krone, Hungarian forint, Polish zloty and Romanian leu (EU Member States currencies), US dollar, Japanese yen, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, New Zealand dollar, Singapore dollar, Norwegian krone and Mexican peso (BIS most traded currencies)).
- To use the "standard delivery period" for all other currency pairs to define FX spot contracts.
- Where contracts for the exchange of currencies are used for the sale of a transferable security, to use the accepted market settlement period of that transferable security to define FX spot contracts, subject to a cap of 5 days.
- An FX contract that is used as a means of payment to facilitate payment for goods and services should also be considered an FX spot contract.

Watch what ESMA and national competent authorities do next; the FCA's position is not compatible with the Commission's guidelines on the definition of an FX spot contract.

### Scope – AIFs

Pursuant to the transitional provisions of AIFMD, an AIFM must have submitted its application for authorisation by 22 July 2014. Once an AIFM is authorised, any AIF for which it is the appointed AIFM becomes subject to EMIR.





## EMIR Implementation timetable – next phase: reporting of exposures (valuation and collateral)

The EMIR Regulation was adopted 4 July 2012 and entered into force 16 August 2012.

EMIR is being implemented on a staggered basis with certain EMIR obligations already in force.

Staged implementation timetable:

- **As of 16 August 2012**, record keeping requirement for OTC derivatives and Exchange Traded Derivatives (ETD) entered on or after 16 August 2012
- **As of 15 March 2013**, confirmation and daily valuation requirements for non-cleared OTC derivatives entered on or after 16 August 2012
- **As of 15 September 2013**, portfolio reconciliation and compression and dispute resolution requirements apply to non-cleared OTC derivatives outstanding as of 15 September 2013
- **As of 12 February 2014**, reporting to Trade Repositories for all derivatives relating to all asset classes with “Backloading” (i.e. trades outstanding on 16 August 2012 and live, or entered into on or after 16 August 2012 but not outstanding, need to be reported)
- **As of 12 August 2014**, reporting to Trade Repositories of data on exposure i.e. valuation and collateral for all derivatives
- **Q2 2015 (estimated)**, clearing obligation will commence for clearing members
- **Q4 2015 (estimated)**, margining for non-cleared OTC derivatives on a phased implementation timetable will begin
- **Q2 2016 (estimated)**, clearing obligation for non-clearing members will commence



## ESMA Q&A

ESMA published its 10th update of its [Q&A](#) dated 10 July 2014. Note the questions on reporting of valuation and collateral and a question on reporting contracts with no maturity date such as Contracts for Differences (CFDs) (TR Q34).

## The European Commission FAQs

The Commission published a new set of [FAQs](#) dated 10 July 2014 on issues pertaining to CCPs.



## Declaration of eligibility for clearing by ESMA

EMIR sets out a procedure to work out if an OTC derivative should be subject to mandatory clearing. There are two available methods: a so-called “top down” approach, which ESMA initiates and so-called “bottom up”, which the Central Counterparties (CCPs) initiate by a competent authority authorising a CCP to clear and notifying ESMA. Only the latter has been used so far.

The steps in the procedures are as follows:

- Within 6 months of authorisation of a CCP to clear OTC derivatives, ESMA consults on whether to impose mandatory clearing and draft an RTS for Commission endorsement
- The European Commission has 3 months to endorse the RTS
- Council/European Parliament can object within 1 month of adoption, extendible by a further month (or 3+3 months if the Commission amends ESMA's draft)

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- The RTS must be published in Official Journal and will specify start date and any phase in period

Thus the timing of the entry into force of a clearing obligation for any instrument depends on the speed of concluding the consultation process and the adoption of the RTS, whether the Council or the Parliament object to the RTS, publication in the Official Journal and the time allowed for conformance with the new requirements. This process can take over 20 months.

## **ESMA consultations on the clearing obligation under EMIR dated 11 July 2014**

We are currently in the first stage of the process set out above for certain classes of OTC derivatives. Following the various CCPs notifications, ESMA analysed the classes of transactions notified and determined that some IRS and CDS classes should be subject to the clearing obligation. On 11 July 2014, ESMA launched a first round of consultations in relation to the clearing of certain classes of IRS and CDS. The [IRS Consultation Paper](#) is open for feedback until 18 August 2014 and the [CDS Consultation Paper](#) until 18 September 2014. It is noted that, ESMA is considering a longer phase-in period for non-clearing members; there are many variables in the timing but an estimate is Q2 2016.

## **“Frontloading”**

The frontloading requirement is the obligation to clear OTC derivative contracts entered into after a CCP has been authorised under EMIR and before the date of application of the clearing obligation. Therefore, the frontloading requirement implies that contracts concluded on a bilateral basis following the authorisation of a CCP might become subject to the clearing obligation before their expiration date thus creating legal and commercial uncertainty during this period.

ESMA stated, in a letter dated 8 May 2014, that they wished to modify the frontloading requirement so that it would run from entry into force of the RTS on the clearing obligation till the date of application of the clearing obligation - rather than from the point of authorisation of a CCP. The Commission agreed with this suggestion. ESMA published the [Commission's response](#) dated 8 July 2014. The two ESMA consultation papers referred to above reflect ESMA's position on frontloading.

## **Margin for non-cleared trades - treatment of initial margin for certain FX transactions**

In September 2013, the Basel Committee on Banking Supervision (BCBS) and the International Organisation of Securities Commissions (IOSCO) issued their final report on “Margin requirements for non-centrally cleared derivatives” setting out high level principles.

EMIR (Art 11(3)) sets out a high-level bilateral collateral requirement for non-cleared trades and ESMA is tasked with developing the detail in a Regulatory Technical Standards (RTS). In April 2014, ESMA published its [Consultation Paper](#) on the draft RTS on bilateral margin for non-cleared trades.

In relation to the treatment of initial margin for FX transactions, ESMA has followed the BCBS/IOSCO principles.

The EU proposal is that:

- in relation to “foreign exchange forwards” and “foreign exchange swaps”, the parties may agree in writing that initial margin is not collected; variation margin on these derivatives should be exchanged.
- in relation to “currency swaps”, the parties may agree in writing that initial margin is not collected in relation to the exchange of principal of cross-currency swap; variation margin requirements apply to all other components of cross-currency swaps.

As per the BCBS/IOSCO proposals, the initial margin requirements will be phased in from 1 December 2015 to 1 December 2019. The consultation closed on 14 July 2014.

### III. Central Securities Depositories Regulation

The Central Securities Depositories Regulation (CSDR), due to come into effect from 2015, will create a common regulatory framework for securities settlement across the European Union.

The CSDR mandates the introduction of a shorter, harmonised, T+2 settlement cycle. This means that securities transactions will settle two business days after trade date rather than three.

Technically and functionally, some Central Securities Depositories (CSDs) are ready now to settle on a T+2 basis. Euroclear will be effecting T+2 settlement from 6 September 2014 in advance of the CSDR deadline of 1 January 2015.

### IV. Securities Financing Transactions (SFT) proposal

As part of the Shadow Banking measures and simultaneously with the proposals on EU banking reform, the Commission published a [proposal](#) in January 2014 on reporting and transparency of securities financing transactions i.e. stocklending and repos.

The Commission proposals provide for:

- Transparency to the regulator: reporting of SFTs to a Trade Repository
- Transparency to investors: reporting to UCITS and AIF investors
- Transparency on rehypothecation with (1) risk warning (2) prior express written consent (3) collateral in the name of the receiving counterparty.

The proposal has not been agreed in trilogue and MEPs may push for tighter provisions on rehypothecation including a percentage cap and number of times securities can be rehypothecated.

## 2. Anti-money Laundering Legislation

In February 2013, the Commission presented the two anti-money laundering proposals:

- Fourth Anti-Money Laundering Directive (MLD4)
- Regulation on information accompanying transfers of funds (AMLR)

## Fourth Anti-Money Laundering Directive

MLD4 requires the ultimate beneficial owners of companies and trusts (and other legal arrangements) to be listed in public registers in each EU Member State. In addition the Directive requires banks, financial institutions, auditors, lawyers, accountants, tax advisors, real estate agents and others to be more mindful of suspicious transactions of clients.

The European Parliament voted its first reading of the draft legislation on 11 March 2014 so as to consolidate the work done so far and to ensure that the newly elected MEPs in May 2014 might build on its work, rather than begin from scratch.

The European Parliament's Economic and Monetary Affairs Committee and Civil Liberties, Justice and Home Affairs Committee have published a [press release](#) on the new draft MLD4. It is now unclear when EU Parliament will adopt MLD4. The MLD4 Council text of 13 June 2014 is [here](#).

## Regulation on information accompanying transfers of funds

The draft regulation on wire transfers tightens existing legislation and aims to increase the traceability of payments by requiring the inclusion of information on payees. It will introduce requirements on payment service providers to verify the identities of beneficiaries for payments originating outside the EU for amounts over EUR 1,000, to put in place risk based procedures to determine when to execute, reject or suspend transfers and to keep records for five years.

The draft regulation was voted on by the European Parliament at the same time as MLD4 above. The AMLR Council text of 13 June 2014 is [here](#).

## 3. Regulatory Developments in the European FX Industry

### MiFID – the boundary between an FX financial instrument and a spot FX contract

This remains unresolved. See Section 1 Part II (EMIR) above, for more details. One to watch.

### UK FCA – enforcement action against an FX firm and a thematic review findings published

The UK FCA announced in its [February 2014 Market Watch newsletter](#) that it was engaged in a thematic review of best execution in different markets. In the newsletter, the FCA noted that “brokers in certain markets, including regulated CFD and spread-bet firms and those offering Rolling Spot Forex contracts for difference, may be failing to recognise that their activities fall within the scope of the best execution rules”. i.e. within the scope of the MiFID rules on best execution as transposed in the UK into the FCA rules.

The announcement of this review came on the heels of the [FCA sanctioning of a Forex firm](#) (an online foreign exchange trading service) for breaches of FCA principles regarding fair treatment of customers and for breaches of the best execution rules in relation to its rolling spot forex trading activity. The firm was fined a total of nearly £11 million.

On 31 July 2014, the FCA published its [paper](#) presenting its findings from the thematic review of best execution.

The main messages from the review are that the FCA's review has identified a significant risk that best execution is not being delivered to all clients on a consistent basis: Most firms are not doing enough to deliver best execution through adequate management focus, front-office business practices or supporting controls; firms need to improve their understanding of the scope of their best execution obligations, the capability of their monitoring and the degree of management engagement in execution strategy; all firms also need to prepare for the challenges of MiFID II implementation in this area.

The FCA will provide individual feedback to the firms in the thematic sample and will require those firms to take immediate action to address all areas of its findings that are relevant to them. All other investment firms should review their arrangements for delivering best execution, improve their current systems and controls and be ready for the implementation of future policy change.

## 4. EU Financial Transaction Tax (FTT)

Before the European parliamentary elections, the [EU Council Presidency published a note](#) and 10 of the 11 participating Member States (without Slovenia for reasons as yet unknown) have issued a [joint statement](#) on the current “state of play” as regards the proposed EU FTT. The 11 FTT participating Member States are Germany, France, Italy, Spain, Austria, Portugal, Belgium, Estonia, Greece, Slovakia and Slovenia. Given the political will amongst participating Member States to agree the form of FTT before the European parliamentary elections, the two communications largely reflect a failure by participating Member States to reach substantive agreement within this timescale.

The note and joint statement provide formal confirmation that Member States participating in the FTT project have reached broad political agreement to work towards progressive implementation of an FTT on “shares and some derivatives,” with the wider objective of expanding the FTT at some unspecified point in the future. There are no further details in relation to this revised FTT proposal on shares and derivatives.

The Presidency's note provides no timeline for agreeing a revised FTT proposal, but the joint statement states that participating Member States intend to “finalise viable solutions...taking into account the concerns voiced by non-participating Member States” by the end of this year, with a view to implementing an initial phase FTT by January 2016 at the latest.

There is no update to the [Commission's webpage on FTT](#).

## 5. Foreign Account Tax Compliance Act (FATCA)

The Foreign Account Tax Compliance Act (FATCA) is US tax legislation which introduces a new – de facto extra-territorial - reporting and withholding regime intended to prevent US investors from evading tax by investing through non-US entities.

FATCA requires Foreign Financial Institutions (FFIs) to enter into an agreement with the US Internal Revenue Service (US IRS) and to report information to the IRS regarding their US account holders.

Intergovernmental agreements (IGAs) provide an alternative approach to FATCA implementation. There are two types of IGAs. The first type of IGA (Model 1) requires FFIs to report all FATCA-related information to their own governmental agencies, which would then report the FATCA-related information to the US IRS.

A Model 1 IGA between the US and Cyprus, is treated to be “in-effect” by the US Treasury and the US IRS as of 22 April 2014. The US and Cyprus governments have reached an agreement in substance in relation to the terms of the agreement and Cyprus has expressly consented to be included in the relevant “in-effect” list. The text of the IGA has not yet been published.

FFIs resident in Cyprus have until 31 December 2014 to register with the US IRS on the FATCA registration portal.

Under the Model 1 IGA framework, Cypriot Reporting Financial Institutions will be required to identify US accounts and report specified information about those US accounts to the Cyprus competent authority. The Cyprus authority will then pass this information on to the IRS on an automatic basis. As a result of the IGA, Cypriot Financial Institutions will be ‘deemed compliant’ with the requirements of US FATCA and will not be subject to the withholding tax that may otherwise be applied by US withholding agents.

## 6. Fund Regulation



### **Alternative Investment Fund Managers Directive (AIFMD)**

Some Member States are still in process of transposing the Directive. The transitional provisions of AIFMD expired on 22 July 2014. By this date, AIFMs should have submitted their application for authorisation if they wished to continue to manage and market funds which fall within the scope of AIFMD.

ESMA reporting guidelines will apply two months after publication of official translations on ESMA website (likely to occur early in Q3 2014).



## Passporting of restricted MiFID investment services under Art 6(4) of AIFMD

MiFID II (Art 92) has amended AIFMD (Art 33) to clarify that the restricted MiFID services which AIFMs are allowed to provide (i.e. portfolio management; investment advice, safekeeping of assets and receipt and transmission of orders) can be passported into other Member States. The Commission had set out in a now deleted Q&A on (ID1144), that the AIFMD passport regime was not available to the MiFID services under Art 6(4) of AIFMD.

Member States must apply the passporting regime from 3 July 2015 but ESMA has recommended that national competent authorities accept passport notifications before 3 July 2015.

## UCITS V

UCITS V was one of the priority dossiers which, was agreed by the European Parliament on 15 April 2014 before the Parliamentary elections. The [final text](#) was made available on 16 July 2014. The Council adopted UCITS V on 23 July 2014. We await publication of the final text in the Official Journal.

The key areas of changes relate to remuneration policies and depositary functions. Remuneration policies need to be introduced for all risk takes involved in managing UCITS funds and the depositary provisions line up to those of AIFMD.

## Money Market Funds (MMFs)

The European Council and European Parliament had begun trialogue discussions but due to differences in view on this [proposal](#) there was no European Parliament vote in the last parliament. The dossier is now a matter for the next Parliament. Work will not recommence in European Parliament till after the summer and it is not currently known what approach will be taken e.g. start again/ pick up where left off/accept part.

The ECB published an [opinion](#) dated 22 May 2014 on the Commission's proposal in which, inter alia, it suggests considering more flexible means for maintaining the net asset value buffer for constant net asset value MMFs.

On 24 July 2014, the US Securities and Exchange Commission approved amendments to rules that govern money market funds. The US have settled for a hybrid solution. It is likely that the various interest groups will use whichever part of the US final position to advance their own position in the EU so the US position does not give us a clear steer for EU developments.

## 7. EU Bank Recovery and Resolution Directive (BRRD)

### EU Directive establishing a framework for the recovery and resolution of credit institutions and investment firms

**BRRD** was agreed by the European Parliament on 15 April 2014. The text was published in the Official Journal on 12 June 2014. BRRD applies to EU credit institutions and certain investment firms. BRRD is a recovery and resolution mechanism operating at national Member State level as opposed to the Single Resolution Mechanism (SRM) under the Banking Union project which will operate at EU level.

The BRRD lays out measures to ensure:

- banks and authorities make adequate preparation for crises;
- national authorities are equipped with the necessary tools to intervene in a troubled institution at a sufficiently early stage to address developing problems;
- national authorities have harmonised resolution tools and powers to take rapid and effective action when bank failure cannot be avoided;
- authorities cooperate effectively when dealing with the failure of a cross-border bank; and
- banks contribute to resolution financing arrangements to support the costs of restructuring.

In order to be effective, the resolution tools require a certain amount of funding. Member States are required to set up ex-ante financing arrangements, funded with contributions from banks and investment firms in proportion to their liabilities and risk profile. To that end, contributions are to be raised from banks/investment firms annually in order to reach a target funding level of at least 1% of covered deposits over a 10 year period. The European Commission has been consulting on the levels of contributions to the resolution financing arrangements established under BRRD and SRM (the consultations closed on 14 July 2014).

## 8. CySEC developments

### AIFMs

CySEC issued [Circular CI56-2014-20](#) on 4 June 2014 to serve as a reminder for [Circular CI56-2013-01](#) issued on 26 July 2013, relating to the **arrangements for the registration of AIFMs** who do not exceed the threshold of section 4(2) of the Alternative Investment Fund Managers Law of 2013 (L. 56(I)/2013). Based on the said Circulars, AIFMs established in Cyprus who do not exceed the prescribed thresholds, had until July 2014 to get registered with CySEC following the procedures prescribed in the Circulars.

### Public Register of Certified Persons

On 6 June 2014, CySEC [announced](#) the updated **Public Register of Certified Persons** employed in IFs, Credit Institutions, Management Companies and Variable Capital Investment Companies. The Public Register is available on CySEC's website found [here](#).



## Consultation Paper re credit given to retail investors for margin trading on securities listed on the Cyprus and Athens stock exchanges

On 12 June 2014 CySEC [announced](#) the publication of [Consultation Paper CP\(2014-04\)](#) for the submission of [comments](#), regarding the upcoming “Directive for the provision of credit for margin trading to retail customers to conduct exchange-traded transactions”. The consultation closed on 20 June 2014.

The upcoming Directive, stipulates that CIFs who provide their retail clients with credit to trade on margin in relation to transactions carried on transferable securities listed on the Cyprus and Athens stock exchanges should, inter alia, a) enter into an agreement with the client, b) maintain proper records, c) maintain a security portfolio, d) maintain additional requirements in case the agreement with the client provides also for Portfolio Management and e) require from the client to restore the maintenance margin when the difference between the total current market value of the security portfolio and the owed amount is less than 50% of the current market value of the security portfolio, or otherwise liquidate the security portfolio if the client does not comply.

## Bank Recovery and Resolution Directive - Data request for a preliminary exercise of the European Commission

On 12 June 2014 CySEC issued [Circular CI144-2014-20](#) to inform CIFs about the adoption by the European Parliament and the Council of the BRRD (see Section 7 above for more details about BRRD).

Via the aforementioned Circular, CySEC has also requested all CIFs that fall under the term ‘investment firms’ referred to in paragraph 2 of the Circular, to complete the Annex attached therein and submit the information in excel format to the electronic address [crdsubmission@cysec.gov.cy](mailto:crdsubmission@cysec.gov.cy), by Tuesday, June 17, 2014, the latest.

## AIFs Directives

On 20 June 2013, CySEC published the [Consultation Paper CP \(2014-05\)](#) for the review and submission of the industry’s comments to the Directives that are planned to be issued in relation to the application of the recently voted AIF Law (see further below for more details). The consultation closed on 11 July 2014.



## Capital Adequacy and Large Exposures of CIFs

CySEC informed Cyprus Investment Firms (“CIFs”) for various important updates which have been implemented, in relation to the capital adequacy and exposures of CIFs, through the issuance of [Circular CI144-2014-22](#) on 20 June 2014. More specifically, CySEC informed CIFs about the following:

- **Own Funds and capital adequacy ratio:** deletion of Article 67(3) of the Law, in relation to the discretion of CIFs that existed in the previous European Directive, for providing a deadline in case the own funds or the capital adequacy ratio fall below the allowable limits.
- **Large Exposures:** pursuant to Article 396(1) of the Regulation (EU) No 575/2013, which entered into force automatically in all Member States from 31 December 2013, large exposures may exceed the allowable limits only in exceptional cases and the competent supervisory authority may give, under justified circumstances, limited time to remedy the situation.

- **Submission of the capital adequacy and large exposures reports:** CySEC intends to adopt [the Implementing Technical Standard on Supervisory Reporting \(ITS\) in relation with a common framework reference \(COREP\)](#), by amending accordingly the Forms 144-05-06.1, 144-06-08.1 and 144-06-08.2. The said ITS does not provide granting extensions for not submitting the relative forms on the specified submission date. The reporting frequency is specified as quarterly and half yearly depending on the services provided and CySEC is oriented not to make use of the discretion for monthly reporting and will adopt quarterly and half-yearly submission.

## **CIFs Supervisory Functions, Governance Arrangements and Risk Management**

On 27 June 2014, CySEC informed Cyprus Investment Firms (“CIFs”) through the issuance of a [Circular CI144-2014-23](#) of the following:

- **Weaknesses of the effectiveness of the supervisory function of CIFs (Board of Directors and Senior Management)**

Further to CySEC’s on-site inspections during the years 2013-14, several weaknesses have been identified in relation to the Members of the Board of Directors of CIFs such as a) lack of understanding of their obligations, duties and responsibilities, b) not sufficiently aware of the legal framework governing the operations of CIFs, c) not sufficiently aware of the activities performed CIFs which were appointed, d) not having sufficient training on the regulatory developments of the industry, e) insufficient time spent on their duties and f) do not act independently and rarely challenge the management.

- **Governance arrangements - Compliance with Articles 88 and 91 of the European Directive 2013/36/EE**

CySEC has amended the Investment Services and Activities and Regulated Markets Laws of 2007 to 2012 (the “Law”), which is expected to be voted by the House of Representatives and implemented in the coming months. The upcoming changes provide, inter alia, for the following:

- All board members must commit sufficient time to perform their duties in the CIF.
- Each board member must act with honesty, integrity and independence of mind to effectively assess and challenge the decisions of the senior management, where necessary, and to effectively oversee and monitor management decision-making.
- The CIF must devote adequate human and financial resources for the induction and training of the board members.
- The board of directors oversees and is accountable for the implementation of the governance arrangements that ensure effective and prudent management of the CIF, including the separation of duties and prevention of conflicts of interest.
- Those arrangements must comply with the following principles:
  - the board of directors must have the responsibility to approve and oversee the implementation of the CIF’s strategic objectives, risk and internal governance,
  - the board of directors ensure the integrity of the accounting and financial reporting systems, including financial and operational controls and compliance with the Law and related standards,
  - the board of directors must oversee the process of disclosure and communications,
  - the board of directors must be responsible for providing effective oversight management.

- **Governance arrangements & Board of Directors composition - Compliance with Article 91 of the European Directive 2013/36/EE**

CySEC has amended the Law, by introducing provisions in relation to the composition of the board of directors of CIFs, which is expected to be voted by the House of Representatives and be implemented in the coming months. The new provisions of the Law provide for the following:

- a. The overall composition of the Board must reflect an adequately broad range of experiences.
- b. The board members of a CIF, which is significant in terms of its size, internal organisation and the nature, scope and complexity of its activities, must not hold more than one of the following combinations of directorships at the same time:
  - i. one executive directorship with two non-executive directorships,
  - ii. four non-executive directorships.

Note: The Law provides some exemptions from the application of the above provisions.

- c. The board of directors must possess adequate collective knowledge, skills and experience to be able to understand the CIF's activities, including the main risks.
- d. The chairman of the board of directors must not exercise simultaneously the functions of a chief executive officer within the same CIF, unless authorised by the Commission.

- **Risk Management - Compliance with Article 76 of the European Directive 2013/36/EE**

CySEC is in the process of drafting a Directive on the Risk Management arrangements of CIFs (expected to be published soon). Briefly, the new provisions cover, among others, the following:

- a. The responsibilities of the board of directors in relation to risk management.
- b. The establishment of a risk committee, in case the CIF is significant in terms of its size, internal organisation and the nature, scale and complexity of its activities.
- c. The qualifications of the members of the risk committee and their responsibilities.
- d. The establishment of a risk management department, where appropriate and proportionate in view of the nature, scale and complexity of the business activities of the CIF, and the nature and range of investment services and activities.

## European Commission press release re its legislative proposal to regulate Money Market Funds (MMFs)

On 1 July 2014, CySEC [informed](#) the supervised entities, stakeholders and the investing public, of the press release of European Commission regarding its legislative proposal to regulate Money Market Funds (MMFs).

The full text of the European Commission press release can be found [here](#).



## Alternative Investment Funds (AIFs) Law voted

On 10 July 2014 the Cyprus House of Representatives enacted the [Alternative Investment Funds Law of 2014](#) ("AIF Law"). The AIF Law replaces the International Collective Investment Schemes Law (the "ICIS Law") of 1999, aligning Cyprus with the latest EU directives on asset management.

The supervision of AIFs is transferred from the Central Bank of Cyprus to CySEC that is now responsible to oversee the full spectrum of the legislative framework for all fund investment products, asset managers and investment firms.

The transitional provisions of the AIF Law as per Article 120 of the said Law, will allow existing private ICIS, including those whose application remains pending before the Central Bank of Cyprus upon enactment of the AIF Law, to continue their operation as light-touch regulated AIFs. Existing private ICIS must, within four months from enactment of the AIF Law either:

- i. Submit the necessary documents, that will allow them to operate as light-touch regulated AIFs (no license required; only additional information); or
  - ii. Apply for a licence to operate as a public AIF or an experienced investor AIF; or
  - iii. Opt-in to the AIFM Law regime as self-managed AIFs, where applicable.
- Non-compliance with any of the above possibilities will effectively require private ICIS to enter into dissolution and liquidation within six months following expiration of the four months' compliance deadline; dissolution and liquidation will be governed by the (repealed) ICIS Law.
  - Pending applications for private ICIS shall be examined by CySEC according to the new light-touch regulated AIF regime, unless a license to operate as a public AIF or an experienced investor AIF is applied for upon enactment of the AIF Law.

Further to the above, the new AIF Law provides two classes of AIFs, namely AIFs without any limitation to the number of investors and AIFs with limited number of investors (i.e. AIFs available to 75 investors or fewer, with assets not exceeding €100 million with leverage or €500 million without leverage and with no redemption rights for a period of 5 years following the date of initial investment).

The main provisions of the AIF Law are listed below:

- **Structural:** An AIF may be structured as a variable or fixed capital company or as a partnership or a limited partnership.
- **Custodian:** AIFs must appoint a custodian for safekeeping and cash monitoring. The custodian can be an EU member state or a third country institution, subject to CySEC's approval. The custodian can be a credit institution or an investment company or another category of institution that is eligible to be a custodian. An AIF may be exempted from the requirement to appoint a custodian in the case its assets are not eligible for safekeeping (e.g. property investment). It should be noted that AIFs with limited number of investors may be exempted from the requirement to appoint a custodian in the event the total assets under management by the fund are less than €5 million or the fund has up to 5 investors or the assets are not eligible for safekeeping (e.g. property investment).

- **Marketing:** Can be marketed to either well-informed/professional investors or to retail investors. It should be noted that AIFs with limited number of investors can be marketed only to well-informed/professional investors.
- **Umbrella Funds:** The AIF Law allows the set-up of various AIF structures, such as Umbrella Funds (Sub-Funds) having multiple investment compartments, with separate investment policies. This of course, also necessitates complete legal and accounting segregation of assets and liabilities within the same AIF.
- **Listing:** An AIF may be listed on a recognised stock exchange in the EU or in a third country. It should be noted however that only AIFs that are marketed to retail investors can be traded on a recognised stock exchange in the EU or in a third country.
- **Capital Requirements:** AIFs are subject to minimum capital requirements. The minimum share capital is normally €125,000 or €300,000 in case of a self-managed fund.
- **Investment Restrictions:** AIFs may be subject to investment restrictions depending on CySEC's discretion, through the issue of relevant Directives.
- **Licensing:** An AIF licence is obtained via the submission of a full application package for approval to CySEC.

As regards taxation, an AIF, as long as it is incorporated as a Limited Liability Company, will benefit from all advantages that the Cyprus tax system offers, some of which are the following:

- Profits from disposal of shares and other titles are exempt from taxation.
- Exemption of any withholding tax from the payment of dividend and interest to non-residents.
- Dividend income is in most cases exempt from taxation.
- No tax on redemption of units by unitholders.
- The dividends paid to Cyprus tax residents would only be taxed at 3% defence tax whereas for a normal company this tax is 17%.
- The wide network of double tax treaties of Cyprus will ensure that taxation is kept at the minimum for dealings with these countries.
- In the case that the AIF is managed and controlled from outside the Republic it will be considered a non-Cyprus tax resident and full exemption from Cyprus tax would be applicable.



## Consultation Paper for upcoming Directive concerning Tied Agents

On 21 July, CySEC [announced](#) the publication of the [Consultation Paper CP \(2014-06\)](#) for the submission of comments regarding the upcoming publication of a new Directive concerning Tied Agents. The consultation closed on 01 August 2014.

The respective Directive which determines and particularises the provisions of Article 40 of the Law, shall apply in relation to:

- CIFs which intend to appoint a Tied Agent established in the Republic of Cyprus.
- IFs of another Member State, which intend to appoint a Tied Agent in the Republic of Cyprus.
- CIFs which intend to appoint a Tied Agent established in another Member State that does not allow the appointment of Tied Agents.



The proposed Directive specifies, inter alia, the procedure for the registration in and removal from the public register of Tied Agents, the information, details and documents (incl. forms) that should be submitted to CySEC for the notification to appoint a Tied Agent, the procedure for the assessment applied by CySEC following receipt of a notification for the appointment of a Tied Agent and the information that must be disclosed during and upon termination of the business relationship with a Tied Agent.

## **Capital Adequacy and Large Exposures implications on potential removal of Russian Federation from list of equivalent CRD countries**

CySEC asked during July certain CIFs to provide their view regarding the impact on Capital Adequacy and Large Exposures in case Russia is removed from the list of equivalent third countries in the near future, for CRD purposes.

According to Regulation (EU) No 575/2013, certain categories of exposures to entities located in third countries can be subject to a more appropriate, and typically more favourable prudential treatment provided that the European Commission adopts an implementing act determining that a third country's prudential supervisory and regulatory requirements are at least equivalent to those applied in the EU.

According to CySEC, the Commission is examining whether the prudential supervisory requirements applied in a number of third countries, including Russia, are at least equivalent to those applied in the EU. Russia is considered as an equivalent country for CRD purposes, according to the Directives of CySEC (DI144-2007-05 & DI144-2007-06).

# Acronyms & Definitions used

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFMs)
AMLR	Regulation on information accompanying transfers of funds
BCBS	Basel Committee on Banking Supervision
BRRD	Directive 2014/59/EU Bank Recovery and Resolution Directive: establishing a framework for the recovery and resolution of credit institutions and investment firms
CCP	Central Counterparty
CDS	Credit Default Swap
CFD	Contract for Difference
CIF	Cyprus Investment Firm
Commission	European Commission
COREP	Common Reporting
CP	Consultation Paper
CRD	Capital Requirements Directive
CSD	Central Securities Depository
CSDR	Regulation on improving securities settlement in the European Union and on central securities depositaries
CySEC	Cyprus Securities and Exchange Commission
EBA	European Banking Authority
EMIR	European Market Infrastructures Regulation – Regulation (EU) 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories
ESMA	European Securities and Markets Authority
ETD	Exchange-Traded Derivative
EU	European Union
FATCA	Foreign Account Tax Compliance Act
FAQs	Frequently Asked Questions
FCA	UK Financial Conduct Authority
FFI	Foreign Financial Institutions
FTT	Financial Transaction Tax
FX	Foreign Exchange
ICIS	International Collective Investment Schemes
IGA	Intergovernmental Agreement
IOSCO	International Organisation of Securities Commissions
IRS	Interest Rate Swap
ITS	Implementing Technical Standards

MAD	Directive no.2014/57/EU of the European Parliament and of the Council on criminal sanctions for market abuse
MAR	Regulation no. 596/2014 of the European Parliament and of the Council on insider dealing and market manipulation (market abuse)
MEP	Member of the European Parliament
MiFID	Markets in Financial Instruments Directive – Directive 2004/39/EC of the European Parliament and the Council
MiFID II	Directive no. 2014/65/EU of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (compromise reached, number to be assigned)
MiFIR	Regulation no. 600/2014 of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories [EMIR]
MLD4	Fourth Anti-Money Laundering Directive
MMF	Money Market Fund
MTF	Multilateral Trading Facility
Official Journal	The Official Journal of the European Union
OTC	Over-the-Counter
OTF	Organised Trading Facility
Q&A	Questions and Answers
RM	Regulated Market
RTS	Regulatory Technical Standards
SFT	Securities Financing Transaction
SI	Systematic Internaliser
SRM	Single Resolution Mechanism
TR	Trade Repository
UCITS	Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)
UCITS V	Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions
US	United States of America
US IRS	United States Internal Revenue Service

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