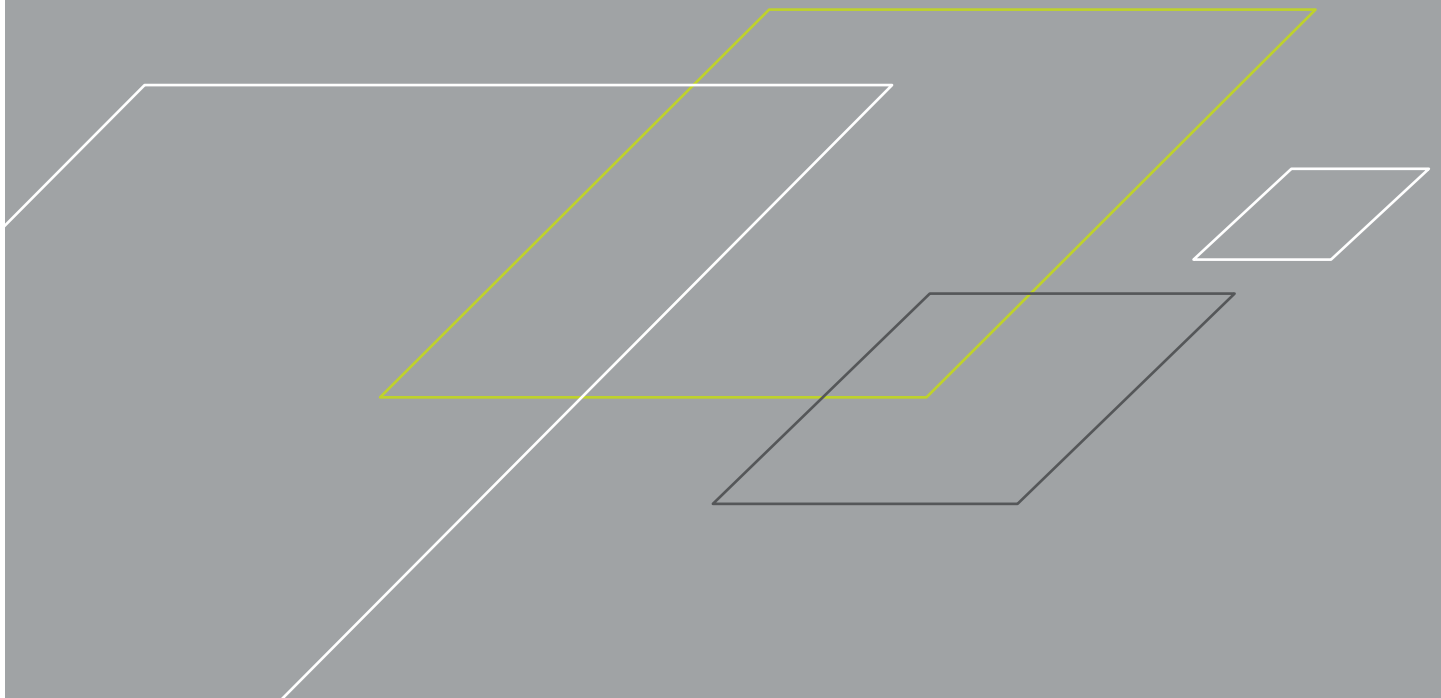




NORTHERN
TRUST

REGULATORY TRENDS IN EMEA

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This booklet outlines our thinking about recent regulatory changes, and how they might affect your programs. It summarises recent developments impacting the financial industry and how we anticipate supporting our clients through this period. For more information, contact your Northern Trust representative or visit northerntrust.com.

REGULATORY OUTLOOK

Financial services legislation is inevitably impacted by the political agenda; and for various reasons the order of the day continues to become increasingly protectionist. There is a move away from global policy making and something of a reduction in the appetite of jurisdictions to open their markets and allow for cross-border cooperation. An example of this can be seen in the way in which the EU's equivalence determinations appear to be becoming stricter; Switzerland being the recent recipient of a retracted equivalence status for its trading venues. Other so called third countries likely to be subjected to moving goalposts on what amounts to matters like equivalence and substance whilst negotiations on the UK's departure from the EU remain ongoing.

However, there are exceptions to this general status quo: the coordinated efforts to extend the timeframe within which the initial margin rules will apply to uncleared derivatives across multiple jurisdictions is a good example of cross-border collaboration, and is discussed in further detail within this newsletter. The recent agreement between Chinese and British regulatory authorities has now enabled foreign companies to list their shares in mainland China for the first time, again showing the efforts of authorities to act in a mutually beneficial manner.

Whether change is initiated locally or not, the level of regulation that must be adhered to continues to require vigilant monitoring. Northern Trust dedicates significant time to tracking and analysing the implications of regulatory change; if you would like to discuss any of the items in this newsletter in more detail please do not hesitate to contact us.



Jean White
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WHAT ABOUT BREXIT?

Where to begin. We have all been gripped by the saga surrounding the political tit-for-tat which has become the norm. The political narrative tends to bring about tinnitus, making the ability to determine the implications for a financial services perspective all the more difficult.

Our ongoing analysis continues to be part factual, part educated guesswork and part complete finger in air hypothesis.

For the first time in two years, this article will be short (albeit not sweet). There is little that can be done to mitigate the challenges surrounding industry infrastructure (equivalence for UK venues remains outstanding) or market volatility the UK is likely to face. Where change can be effectively implemented to reduce the risk posed by the still possible (according at least to Boris) eventuality of a no deal outcome, most entities have taken steps to do so. We continue to have conversations with clients on not only this topic, but the potential complication to rear its head should there be a general election followed by a Corbyn-led Government. Should you wish to discuss any of these topics in further detail then, as with the above, please do not hesitate to contact your Northern Trust representative.

INTERBANK OFFERED RATES (IBOR)

Work is underway throughout the global financial services industry to prepare for the transition away from IBORs. The diminishing volume of underlying transactions that support panel banks' IBOR submissions is considered less preferable in the long run by global regulators than those based purely on transactions. Target dates have been set to replace the use of IBORs as reference rates, and market participants have been advised to prepare for the transition.

The UK's Financial Conduct Authority (FCA) continues to reaffirm that after 2021 it will no longer compel panel banks to submit the rates required to calculate the LIBOR. Regulators have convened working groups comprised of industry participants to develop alternatives to IBORs and recommendations for transitioning to new reference rates.

The International Swaps and Derivatives Association (ISDA) has confirmed it will amend standard documentation to implement fall backs for key IBORs to alternative risk-free rates. ISDA plans to finalise amendments to the 2006 ISDA definitions and launch a protocol for all IBORS excluding EURIBOR and EUR LIBOR by the end of the year. The protocol will then take effect three months after finalisation.

The IASB (International Accounting Standards Board) has added IBOR Reform and the Effects on Financial Reporting to its standard setting agenda. The FCA has in numerous speeches continued to state the need for firms to end their reliance on LIBOR by the end of 2021, most recently emphasising that they are coordinating closely with counterpart authorities around the world to ensure a consistent approach to the transition globally.

Alongside this, as of 2 October 2019, the calculation of the Euro Overnight Index Average (EONIA) will change. EONIA is currently calculated by the European Central Bank (ECB) based on the loans made by 28 panel banks. EONIA will soon be redefined as the Euro Short-Term Rate (€STR) plus a spread of 0.085% (8.5 basis points). The ECB will first publish the €STR on 2 October 2019, reflecting the trading activity of 1 October 2019.

LIBOR is produced for CHF, EUR, GBP, JPY and USD in seven tenors (Overnight/SpotNext, 1 Week, 1 Month, 2 Months, 3 Months, 6 Months and 12 Months) based on submissions from a reference panel of between 11 and 16 banks for each currency, resulting in the publication of 35 rates every applicable London business day.

The implications resulting from this will be vast, with entities all over the world affected depending upon their exposure to IBORs. Northern Trust has an established global IBOR programme to ensure we effectively work through the change required; planning for LIBOR to cease at the end of 2021 but monitoring progress should this happen sooner. We are also keen to provide our clients with support throughout their efforts; should you wish to discuss this further please contact your Northern Trust representative.

FUND REGULATION

SUPPLEMENTARY RULES ON MARKETING OF FUNDS ACROSS THE EU

Background

A regulation and directive on the facilitation of cross-border distribution of collective investment funds has now been published and will amend the existing EU rules governing AIFs and UCITS. Ultimately, the aim is to remove perceived distribution inefficiencies in order to reduce the cost, complexity and time taken to distribute on a cross-border basis. In a [press release](#) published in February, the EU advised that only 37 per cent of UCITS and about 3 per cent of AIFs are currently registered for distribution into three or more member states; something they attribute in part to various regulatory barriers. The efforts to harmonise these requirements form part of the EU's ongoing efforts to establish a Capital Markets Union.

Key provisions

- **Pre-marketing:** a new definition of pre-marketing would allow new funds to market to potential professional investors without needing to make a formal application under existing regulation; allowing an EU AIFM to test the appetite of investors in a relevant market and subsequently take an informed commercial decision on whether to formally enter the same.
- **Local facilities:** a high level of customer service must be provided to investors across the EU, and asset managers should not have to bear the cost of maintaining a physical presence or local facilities in all host markets; the rules will remove national variation and allow for the information to be made available electronically.
- **De-notification of marketing:** procedures and conditions should be aligned to allow managers of collective investment funds to exit national markets when they decide to terminate the offering or placement of their funds.
- **Alignment:** increased transparency will be introduced and a single online access point created for accessing information on national rules related to marketing requirements and applicable fees. This should help managers who want to increase their cross-border activities to save the cost of legal advice on national rules.

- **Communications:** the requirement to ensure that marketing communications with retail investors are fair, clear and not misleading has been expanded to also apply to professional investors. Note: in some jurisdictions, the UK included, this has always been the case and does not represent a change to the existing rules.
- **Verification:** National Competent Authorities will be able to require AIF and UCITS managers to give them prior notification of their marketing materials before using the same.

It is unclear how the review of AIFMD scheduled for the end of the year will make further changes to the distribution of AIFs, but the presumption is that there will be some additional alteration to the provisions set out within this legislation. This aside, the implications to UK managers distributing funds into the EU also remains largely dependent upon the outcome of the Brexit negotiations.

Northern Trust actions

We continue to monitor the implications to our clients of these changes, and in the meantime offer ongoing support for clients wishing to distribute funds within Europe in the form of consultative support and local agency services. Please contact your Northern Trust representative for further detail.

EUROPEAN CENTRAL BANK (ECB) REGULATION ON STATISTICAL REPORTING REQUIREMENTS FOR PENSION FUNDS

Alongside the changes to the reporting requirements for pension funds recently implemented by [LORP II](#), this [ECB regulation](#) will enhance the level of statistical reporting for pension funds within member states whose currency is the euro (generally referred to as the Eurozone). The purpose of the statistical reporting requirements is to provide the ECB with adequate statistics on the financial activities of the pension fund subsector in the Eurozone.

Under the upcoming reporting requirements, in scope pension funds will need to report: data to their national central banks for statistical purposes, as well as data to their national competent authorities for supervisory purposes. The national central banks will then be obliged to report this information up to the ECB, and the National Competent Authorities will need to report the information they capture to the European Insurance and Occupational Pensions Association (EIOPA).

As there is significant overlap between these two datasets, on 5 November 2018, EIOPA published a taxonomy, recommending that National Competent Authorities use the same in collecting information from pension funds to reduce the effort required from these new rules.

The quarterly reporting requirement will become applicable for the third quarter of this year, and the reports must be submitted at the latest 10 weeks following the end of the quarter. This timeline will be brought forward by one week per year thereafter until 2022 when it shall settle at seven weeks. The annual reporting requirement will become applicable at the end of this year, and the reports must be submitted at the latest 20 weeks following the end of the year. This timeline will be brought forward by two weeks per year thereafter until 2022 when it shall settle at 14 weeks.

There are two levels of reporting required under the regulation:

- Quarterly reporting: end-of-quarter stock data on the assets of pension funds, including quarterly revaluation adjustments or financial transactions concerning assets. Non-money market funds' shares/units shall be broken down by investment asset classes (bond funds, equity funds, mixed funds, real estate funds, hedge funds and other funds);
- Annual reporting: end-of-year stock data on:
 - Liabilities of pension funds at minimum, including annual revaluation adjustments or financial transactions concerning liabilities.
 - Number of members of pension schemes broken down into active members, deferred members and retired members.

Northern Trust actions

We are currently building out our Passport reporting capabilities to assist clients in obtaining the data they require to meet their quarterly reporting obligations (specifically the so-called 'List of Assets' report). There will shortly be further information available on this.

MARKET INFRASTRUCTURE/ GOVERNANCE

THE EU SECURITIES FINANCING TRANSACTIONS REGULATION (SFTR)

Background

The SFTR aims to increase the transparency of certain transactions which currently fall outside the traditional banking sector to enable better monitoring of securities financing transactions (SFTs). SFTs allow market participants to access secured funding and are defined broadly within SFTR to include any transaction which utilizes securities in borrowing or lending cash. This includes: Securities Lending transactions and Securities Lending collateral allocations, repurchase and reverse repurchase transactions, buy-sell back or sell-buyback transactions as well as margin lending transactions (which are not traditionally considered to be SFTs).

As an EU regulation, all EU entities are in scope of the requirements, but there will be indirect implications for non-EU entities trading with EU entities as the EU entities will require certain data to fulfil their reporting obligations. This includes a Legal Entity Identifier (LEI) which most non-EU counterparts will already have been disclosing by virtue of the same being required for MiFID II since January 2018 (as articulated in previous versions of this newsletter).

Key provisions

Although many of the disclosure requirements required under SFTR are already applicable, these are generally not substantially onerous to comply with. The industry has been awaiting publication of the regulatory technical standards for transaction reporting requirements, set to significantly enhance reporting obligations for all who use SFTs. These technical standards were published in March and will become applicable for different entities at different times. Reporting will go live for banks and investment firms on 11 April 2020, CCPs and CSDs will need to begin reporting from 11 July 2020, and most Northern Trust clients (including pension funds, insurance companies, AIFs and UCITS) will be brought into scope of the reporting requirement from 11 October 2020. Non-financial counterparties the applicable date is 11 January 2021.

The key aspects of the new reporting requirements are:

- Both counterparties to an SFT will need to report details on the transaction at individual transaction level to a Trade Repository
- All firms will need an LEI
- Reporting by both counterparties to a trade must match at the Trade Repository
- Every transaction must be given a Unique Transaction Identifier used by both counterparties
- Reporting data will include all loan and return transactions and collateral positions. Additionally many life cycle events will also need to be reported such as changes in value or quantity to open positions
- New trade details must be reported to Trade Repositories on Trade Date +1
- Modifications of open trades, trade terminations and certain information surrounding collateral transactions must be reported to Trade Repositories on Settlement Date +1
- Responsibility to report sits with beneficial owner to the transaction, but the reporting requirement can be delegated to the other counterparty or a third party
- Records of any SFTs concluded, modified or terminated must be kept for at least five years following the termination of the transaction

Northern Trust actions

Northern Trust's SFTR programme has been in place for 18 months. We believe that our role as Securities Lending Agent sets us in an ideal position to provide a comprehensive and robust solution for Securities Lending transaction reporting. Northern Trust will therefore be offering a SFT reporting service to our Securities Lending clients, which will include generation of a UTI for every trade, sharing the UTI with the borrower, reporting collateral positions and providing full visibility of the reports being submitted on your behalf through online portals.

Northern Trust is also working with industry bodies to create a new Master Delegated Reporting Agreement the purpose of which is to provide for both mandatory and delegated reporting of SFTs under SFTR. We will be providing further updates in due course.

Members of our SFTR programme are engaged in industry wide working groups, led by ISLA (International Securities Lending Association), to create industry best practices for SFTR. These best practices will be

essential in ensuring that the industry as a whole is able to deal with the challenges SFTR presents.

We will also be offering a data only solution for our IOO clients trading repos or engaged with Northern Trust for active collateral management. The relatively low data coverage quashed feasibility for a full end-to-end reporting offering, particularly as some of the fields captured may not be in the SFTR reporting format.

Recent update

Northern Trust is working with industry bodies to create a new SFTR Delegated Reporting Agreement, the purpose of which is to provide for both mandatory and delegated reporting of SFTs, as part of the SFTR reporting service that we will be offering to our Securities Lending clients. We will be providing further updates in due course.

EUROPEAN MARKETS INFRASTRUCTURE REGULATION (EMIR/REFT)

Initial Margin on Uncleared Derivatives

Summary

The Uncleared (swaps) Margin Regulations mandate the exchange of Variation Margin (VM) and the exchange of Initial Margin (IM) on Over-the-Counter (OTC) bilateral derivatives, the aim of which is to cover the credit risk of any potential future losses resulting from OTC bilateral derivatives exposure.

The regulations restrict the eligible forms of collateral to be exchanged as IM to highly liquid assets and prescribe methods from which to derive related haircuts. Two-way exchange of IM is required based on a risk-based model or standardized table (or grid), and collateral must be segregated with prohibitions on the same for rehypothecation as well as limitations on cash reinvestment. Specific Credit Support Annexes (CSAs) and custodial documentation will govern new collateral relationships and the compliance dates for IM are based on OTC notional exposure, the definitions of which vary in different jurisdictions.

Update

The thresholds are measured using Aggregate Average Notional Amount (AANA) of uncleared derivatives, to determine if and when an institution will need to comply with the requirements. Both counterparties must be above the relevant threshold in order for the IM requirements to apply. On 23 July, the International Organization of Securities Commissions (IOSCO) formally [announced](#) the addition of a new phase for IM implementation, which essentially provides an extra year's relief for some entities previously within phase-five of application:

PHASE	DATE	THRESHOLD
Phase I	4 Feb 2017	AANA threshold of EUR/USD* 3 trillion
Phase II	1 Sept 2017	AANA threshold of EUR/USD 2.25 trillion
Phase III	1 Sept 2018	AANA threshold of EUR/USD 1.5 trillion
Phase IV	1 Sept 2019	AANA threshold of EUR/USD 750 billion
Phase V	1 Sept 2020	AANA threshold of EUR/USD 50 billion
Phase VI	1 Sept 2021	AANA threshold of EUR/USD 8 billion

*local currency equivalent in other jurisdictions

Northern Trust actions

Collateral for IM must be segregated; Northern Trust's segregated collateral account is an EMIR compliant offering which enhances transparency and safety whilst reducing exposure to counterparties. As a first step to this process, we encourage interested parties to reach out to their Relationship Manager to obtain the applicable legal agreements that will be negotiated by your firm, your broker, and Northern Trust.

Northern Trust continues to evolve our derivatives services. Combined with our custody and collateral management operations outsourcing capabilities, these services help clients respond to the new regulatory requirements and reduce the burden of the transition to a cleared derivative environment.

Northern Trust's collateral management operations outsourcing services comply with IM rules (mandating of calls and exchange of IM for every trade) and incorporate ISDA's SIMM as the most efficient risk-based model in calculating IM. This includes the application of optimisation rules in determining the most efficient assets to pledge which meet the margin eligibility rules.

Furthermore, changes to margin requirements will likely lead to increased demand for highly rated sovereign bonds. Northern Trust is happy to assist our clients in evaluating all potential opportunities for securities lending strategies.

THE CENTRAL SECURITIES DEPOSITORIES REGULATION (CSDR)

Background

CSDR aims to harmonise the authorisation and supervision of Central Securities Depositories (CSDs) within the EU. Far from being a new item of regulatory change, CSDR became applicable back in 2014 with its first provision being to mandate the move to an EU settlement cycle of trade date plus two days (T+2). Subsequently, in 2017 CSDs were obliged to

apply for authorisation and ever since have had to comply with strict organisational, conduct and prudential rules.

Although many CSDR provisions have already been implemented, several key requirements are due to become applicable in 2020. The next significant change CSDR will bring to the industry is set out within provisions referred to as the Settlement Discipline Regime (SDR). Any in scope instrument that is either cleared at an EU central clearing house (CCP) or settled by an EU trading venue or an EU CSD is in scope of the SDR, meaning counterparties to a trade can be caught by the regime even if based outside of the EU.

Key provisions

Cash Penalties and compensation

The SDR will become applicable on 14 September 2020, and require EU CSDs to calculate cash penalties for late matching and late settlement. In the case of the former, penalties will only apply to trades that are confirmed; when CSDR refers to 'matching' it relates to settlement matching. Any transaction that fails to settle on the intended settlement date will incur cash penalties.

CSDR SDR states a requirement to facilitate partial settlement if holdings are available, in order to mitigate exposure to the total penalty, where the counterparty has sufficient assets to settle part of the transactions.

- Late matching penalties can only be calculated once the match has occurred (as it is then known how many days late the matching was beyond the set timeframe), and will be calculated for all days of the late match period, at the individual day's closing price. Late matching penalties will be charged to the party who was last to submit or modified the instruction which enabled the transaction to match.
- Late settlement penalties will be calculated daily for each business day the transaction fails to settle post intended settlement date and the penalty will be imposed against the failing party. It should be noted that the reason for a failed settlement could change throughout the fail period, meaning a penalty could be imposed against both parties.

A failing transaction could incur both late matching and late settlement penalties however; both penalties will not be levied for the same date.

CSDs will send notifications of the penalty amounts payable to their participants on a daily basis. On at least a monthly basis, the CSDs will then pass on a net amount to the participant's cash account in monies owed from penalties. There is a fixed formula used for both late matching and late settlement penalty calculation, which takes into consideration the elements of the trade, asset type and closing daily prices. There is an

opportunity to appeal a penalty from the date the CSD issues the penalty notification until the eleventh business day of the month following that within which the penalty was applied. If a dispute remains open, a bilateral arrangement to resolve the penalty between the two counterparties must be sought.

Mandatory buy-ins and cash compensation

CSDR SDR will also impose mandatory buy-ins, a process that exists today in certain markets but which will be superseded by SDR for all instruments cleared at an EU Central Counterparty (CCP) or settled by any EU trade venue or CSD. If a transaction has still failed to settle within certain timeframes then a buy-in process must be initiated. The relevant timeframes are:

- Four business days beyond the intended settlement date (ISD+4) for equities trading on a liquid market
- ISD+7 for bonds and less liquid securities
- ISD+15 for securities traded on SME growth markets

The business day following the above timeframes, the party due to receive the instrument must appoint a buy-in agent to purchase the securities elsewhere. If a CCP has been used for clearance of the trade, the CCP will be responsible for initiating this buy-in process. The failing party must place the original settlement instruction on hold; the same will be cancelled once the buy-in transaction settles. Any price increase, FX cost, corporate event or buy-in agent fees must be paid by the failing party. A price drop will be deemed to have already been paid; the 'failed to' party will not have to compensate the failing party.

The key process steps involved in the buy-in process are:

- Upon expiry of the extension period the failed-to trading party must appoint a buy-in agent and advise the failing trading party of the same.
- The failing party must put the failing instruction on-hold upon receipt of the buy-in notification.
- Once the buy-in execution has been completed the failed-to trading party must notify the failing party of the outcome of the buy-in including all associate costs.
- If the buy-in could not be executed in full then a cash compensation will be due, this must be calculated and the failing party must be notified of the same.
- Upon settlement of the cash difference between the initial trade and the buy-in, the underlying failing trade must be bilaterally cancelled.

- If the buy-in execution cost is less than the initial trade price then the cash settlement is deemed to have been paid.
- The failed-to party must notify the respective CSDs of the buy-in results.

Northern Trust actions

Northern Trust's CSDR implementation programme remains committed to ensuring we effectively manage all change, and provide our clients with sufficient information in a timely manner to enable them to do the same. As an entity within the trade settlement process, we will receive notification of any fines imposed or due to be received from the relevant EU CSD. We initiated our global CSDR SDR programme last year, as soon as the technical standards were published and the relevant compliance date became known. We have dedicated significant resource to ascertaining the implications of the regime to our internal systems, operational processes and the two way dialogue between us and our clients. As we move closer to September 2020, we are now taking steps to optimize our existing process and effect all operational change required. You will shortly be hearing from us with more detail on the implications resulting from CSDR SDR.

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