

May 6, 2019

Legal News - March-April 2019

In this edition

Capital markets

- Update (MiFID II and MiFIR) of ESMA's *Interactive Single Rulebook*
- Methodological framework for the 3rd Stress Test of EU CCPs by ESMA
- ESMA statement on the clearing obligation of the EMIR REFIT Regulation
- Squeeze-outs and independent appraisal: the AMF is reflecting on possible changes and has announced the creation of a working group

Banking

- Update of the ACPR Authorisations Portal
- ACPR analyses and summaries of French banking groups in the face of climate risk

Collective management

- ESMA Consultation Paper on Article 25 of the *European Long Term Investment Fund (ELTIF) Regulation*

Brexit

- Possible postponement of Brexit until October 31, 2019

Insurance

- CCR Re has created the first sidocar domiciled in France: 157 Re
- The entry of crypto-currencies into life insurance
- The ACPR strikes a company off the list of approved entities
- French insurers facing the risk of climate change

Compliance

- A look back at a year of the GDPR

For any information on any of the subjects covered by this letter, do not hesitate to contact us:

Gilles Kolifrath, Partner

T: +33 (0)1 44 09 46 44, M: +33 (0)6 75 18 84 12

E: gkolifrath@kramerlevin.com

Kramer Levin – 47 avenue Hoche, 75008 Paris

www.kramerlevin.com

Our next seminars..

- 20/05/2019 – **Conference: The new frontiers of asset management** – H. de Vauplane
- 21/05/2019 - **Round table: Crypto assets, what future for this new investment universe?**
H. Bouchetemble, Th. Bonneau, V. Barat, R. Jouaneton and Denis de la Burgade
- 22/05/2019 - **Breakfast: "One year of AMF sanctions decisions on the distribution of financial products"** – H. Bouchetemble, Th. Bonneau, V. Barat, R. Jouaneton and Denis de la Burgade
- 20/06/2019 – Breakfast: **"News - Derivatives and ISDA French Law"** – G. Kolifraith, J. Blanchet et L. Sharkey
- Date to be determined – **RGPD and role of DPO** – G. Kolifraith et E. David

Capital markets

Update (MiFID II and MiFIR) of ESMA's *Interactive Single Rulebook*

On March 13, 2019, ESMA updated its *Interactive Single Rulebook* to incorporate MiFID II Level 2 and 3 measures (including RTS, delegated acts, opinion and Q&A).

In general, this online tool provides a complete overview and easy access to all level 2 and 3 measures adopted in relation to a level 1 text.

To date, the available texts are MiFID II, MiFIR, UCITS and CRAR (*Credit Rating Agencies Regulation*), further updates are obviously planned for the coming months.

Methodological framework for the 3rd Stress Test of EU CCPs by ESMA

On April 3, 2019, ESMA published the methodological framework for its third stress test of EU CCPs. In accordance with the provisions of the EMIR Regulation, ESMA's mission is to initiate and coordinate this type of exercise in order to assess the resilience and security of European CCPs in the face of adverse market developments and to identify any shortcomings.

For this third test, ESMA added a new element concerning concentration risk (in addition to the usual credit and liquidity risk assessments). This new component will be used to assess the impact of the costs of liquidating concentrated positions.

The new stress test includes:

- credit-stress: which assesses the adequacy of CCP resources to absorb losses under a combination of market price shocks and default scenarios of clearing members;
- liquidity-stress: which assesses the adequacy of CCPs' "liquid" resources in a combination of market price shocks, member / liquidity provider default scenarios and additional liquidity stress assumptions;
- concentration risk: which assesses the impact of liquidation costs related to concentrated positions; and
- reverse credit-stress: which increases the number of defaulting entities and the intensity of shocks to identify the level at which resources are exhausted.

ESMA will also conduct additional analyses on the degree of interdependence of CCPs, concentration risks related to credit and liquidity exposures and the analysis of clearing members' defaults.

The General Counsel of the ESRB (European Systemic Risk Board) approved the case of the "crisis" scenario provided for in this stress test and forwarded it to ESMA.

The ECB, in close collaboration with the ESRB and ESMA, has developed and calibrated the so-called "crisis" scenario of triggering one or more sources of systemic risk for the EU financial system, as identified by the ESRB.

The purpose of these resilience tests is not to assess CCPs' compliance with regulatory requirements, but to assess their resilience to macroeconomic scenarios that may have an EU-wide impact.

This third-generation stress test will cover the 16 CCPs authorised in the EU. For the three British CCPs (LCH Ltd, ICE Clear Europe Ltd and LME Clear Ltd), ESMA will include them in its exercise, unless there is a no-deal Brexit.

ESMA statement on the clearing obligation of the EMIR REFIT Regulation

On March 28, 2019, ESMA addressed all financial and non-financial counterparties subject to the EMIR Regulation. It specifies when they must determine whether they are subject to the clearing obligation under the new EMIR REFIT regime and also when they must inform ESMA and their relevant competent authority that they are indeed subject to the clearing obligations, i.e. the day on which the Regulation enters into force.

The new regime introduced by the EMIR REFIT Regulation allows financial or non-financial counterparties to determine whether they are subject to clearing obligations according to the asset classes concerned by calculating their threshold crossing on the basis of their cumulative average month-end position over the last 12 months. This calculation is optional.

When they choose not to carry out the calculation or when the result of this calculation exceeds the clearing thresholds, these financial or non-financial counterparties are required to immediately inform ESMA and the relevant competent authority. They then become subject to the clearing obligation for OTC derivatives contracts entered into or novated, four months after this notification. However, there are some nuances for these two regimes:

- on the scope: when non-financial counterparties perform the calculation, they are only subject to the clearing obligation for OTC derivative contracts relating to asset classes for which the result of the calculation exceeds the clearing thresholds (unlike the rule applicable to financial counterparties of: *breach one, clear them all*);
- on the calculation basis: financial counterparties should only include derivatives that do not contribute to reducing risk.

However, the EMIR REFIT Regulation will apply as soon as it enters into force without delay. As a result, financial and non-financial counterparties with positions in OTC derivative contracts who choose to calculate their cumulative average month-end position for the last 12 months

will have to determine the result of this calculation on the day of entry into force. They are therefore already expected to collect all the necessary data.

In addition, it also means that all financial and non-financial counterparties that do not opt for the calculation (or if the result of this calculation is higher than one of the clearing thresholds) must immediately notify ESMA and the relevant competent authority as soon as the Regulation enters into force.

Squeeze-outs and independent appraisal: the AMF is reflecting on possible changes and has announced the creation of a working group

On March 26, 2019, as part of the PACTE bill, the AMF decided to initiate a review of possible changes in practices and regulations relating to squeeze-outs and independent appraisal, with the aim of better protecting minority shareholders.

As it stands, the bill provides for the possibility of implementing a mandatory squeeze-out following a public offer, provided that minority shareholders do not hold more than 10% of the capital and voting rights, compared with 5% currently. In this context, the AMF wanted to reflect on the means that could be implemented to ensure better protection for minority shareholders. This reflection is extended to independent appraisal, historically linked to the squeeze-out, and follows on from the work carried out in 2005 by the working group then chaired by Jean-Michel Naulot, on strengthening independent financial valuation in the context of public offerings and mergers of listed companies.

For this reason, the AMF has announced the creation of a working group to consider ways to improve the practices and regulations applicable to squeeze-outs and independent appraisals. The following themes in particular are at the heart of the group's work:

- the financial conditions under which the squeeze-out is to be carried out and the terms of the AMF's supervision of these conditions; and
- the work carried out by the independent expert: control by the target company's corporate bodies, conditions of appointment of the expert, remuneration, duration of the assignment, interactions with stakeholders, etc.

The group should report its recommendations on regulatory developments and professional practices by the end of the first half of the year.

Banking

Update of the ACPR Authorisations Portal

The Authorisations Portal allows all financial institutions and insurance companies to submit files for the Authorisations Department (particularly since its launch in November 2018, files for the appointment or renewal of officers, members of corporate bodies and managers of key functions, as well as files for payment service providers).

From May 2019, this service will allow the Authorisations Department to examine any other procedure: approvals, crossing thresholds in the capital, portfolio transfers, registration or recording, and simple declarations.

Paper filings will therefore be obsolete and requests will be made directly on the Portal where documents will be uploaded by declarants who will be able to track the status of their files.

ACPR analyses and summaries of French banking groups in the face of climate risk

Global warming will have many consequences in addition to environmental issues. From the consideration of climate change and its impact on the economy to the implementation of Article 173 of the Energy Transition for Growth Act, the ACPR updated on April 10, 2019 its analyses and summaries of banking groups on these issues.

Through the analysis of the responses to a questionnaire in the summer of 2018, the ACPR has taken stock of developments since the publication of the report to the Government in March 2017 on the financial risks related to climate change to which banking groups are exposed.

The ACPR has found that climate risk is increasingly recognised within banking groups at the level of:

- the strategy of banking groups (divestment of certain greenhouse gas sectors); and
- the risk management of major groups (CSR functions, portfolio sensitivity to these new factors).

Regarding generic climate risk, the ACPR identifies three main categories of risks:

- liability risk (near-zero exposure);
- physical risk (low exposure); and
- transition risk (moderate exposure).

Finally, the ACPR concludes with several recommendations for better consideration of the risks associated with climate change, including the role of supervisory authorities and regulators and the improvement of market practices.

Collective management

ESMA Consultation Paper on Article 25 of the *European Long Term Investment Fund (ELTIF) Regulation*

On March 28, 2019, ESMA launched a public consultation on European Long-Term Investment Funds (ELTIFs).

This draft RTS must determine:

- the criteria for determining the circumstances in which the use of derivative financial instruments is used solely for hedging purposes;
- the circumstances in which the life of an ELTIF is considered to be sufficiently long;
- the criteria to be used for certain elements of the detailed timetable for the orderly transfer of ELTIF assets;
- cost disclosure; and
- the facilities offered to retail investors.

ELTIFs are designed to increase the amount of non-bank financing available to companies investing in the EU's real economy. They are also intended to enable investors to invest in long-term companies and infrastructure projects. As such, ELTIFs are an important part of European efforts to stimulate long-term investment.

The consultation is open for comments until June 29, 2019.

Brexit

Possible postponement of Brexit until October 31, 2019

A compromise has been reached between the United Kingdom and the EU on the date of implementation of Brexit. The agreement was reached on April 12, 2019, several days after the initial deadline of March 29, 2019, and will allow a "flexible" exit from the United Kingdom until October 31, 2019 (Theresa May initially chose June 30, 2019 as the postponement date).

There is no indication of the outcome of future negotiations or the context in which Brexit will take place, some even talking of a "*Halloween Brexit*".

One of the issues is the European elections that are expected to take place between May 23 and 26, 2019 - in the absence of ratification of a withdrawal agreement by May 22 - in which the United Kingdom will have to participate. In the event of non-compliance with this condition of participation in the elections, the withdrawal would take place on June 1, 2019.

During this six-month extension, the United Kingdom should be able to ratify the withdrawal agreement, reconsider its Brexit strategy or revoke Article 50 of the EU Treaty and thus no longer leave the EU. The EU Court of Justice, in a plenary assembly judgement of December 2018, had already ruled that the United Kingdom could unilaterally, unequivocally and unconditionally revoke the notification of its intention to withdraw from the EU.

Insurance

CCR Re has created the first sidecar domiciled in France: 157 Re

The creation of 157 Re is particularly interesting since it is the very first *sidecar* to adopt the form of a French securitisation fund (FCT), an instrument used until now only for the securitisation of financial assets.

157 Re is therefore an FCT with sub-funds bearing insurance risks governed by specific provisions of the French Monetary and Financial Code. It has been approved by the ACPR and has had its tax regime, particularly with regard to investors, clarified by the Tax Administration.

It is highly likely that this transaction will be quickly replicated on the market to cover other types of insurance risks, which ultimately paves the way for the development of an "Insurance-Linked Securities" (ILS) market in Paris.

The first sub-fund of the 157 Re 19 fund has been structured as a *sidecar* assuming 25 of the risks of the *property cat* portfolio underwritten worldwide by CCR Re for part of 2019. The risks are retroceded by CCR Re under a reinsurance contract concluded between CCR Re and the sub-fund. Retroceded risks are hedged by issuing units, the proceeds of which have been invested in risk-free investment securities.

This new fully guaranteed capacity will be used by CCR Re to access a competitive and flexible source of investors, while pursuing organic, profitable and diversified growth.

CCR Re considers that this operation "*demonstrates the innovative capacity of the Paris financial centre, through the creation of the first securitisation mutual fund bearing insurance risks that meets the needs of both the transferor and investors*"¹.

On April 1, 2019, Bruno Le Maire, French Minister of Economy and Finance, stated that "*the controlled development of alternative reinsurance instruments in France may represent new opportunities for investors as well as for insurance and reinsurance professionals. This successful launch proves this and once again demonstrates the attractiveness of the Paris financial centre.*"

¹ <https://www.ccr.fr/-/ccr-re-annonce-la-creation-du-premier-sidecar-domicilie-en-france>

The entry of crypto-currencies into life insurance

Article 21 of the Pacte Act, definitively adopted by Parliament on April 11, 2019, introduces the possibility for specialised professional funds (FPSs) that are eligible for life insurance to invest in all types of unlisted assets, including cryptoassets.

From now on, there will no longer be any limits on the assets in which FPSs eligible for life insurance can invest. A decree will, however, specify the conditions regarding the financial situation or experience of the investor.

In parallel to Article 21, Article 26 *bis* of the Pacte Act amends the provisions of the Monetary and Financial Code relating to assets eligible for investment by FPSs.

The introduction of such a possibility will, in our opinion, remain limited in its application insofar as only professional investors, i.e. individuals with a portfolio of at least €500,000 and having worked in finance for at least 12 months, will be eligible. In addition, the high volatility of cryptoassets could discourage investors.

The ACPR strikes a company off the list of approved entities

On April 8, 2019, the ACPR Sanctions Committee ordered the striking-off of a company from the list mentioned in Article L. 612-21 of the Monetary and Financial Code.

From November 13 to December 20, 2017, the company was subject to an on-site audit to assess the compliance of its anti-money laundering and anti-terrorist financing mechanism ("AML-CFT") which, following an audit report, gave rise to the opening of disciplinary proceedings.

This decision by the Sanctions Committee, which is one of the most severe, reminds us how important it is for companies subject to the obligations of due diligence with regard to customers in business relationships and the freezing of assets to comply with it with the greatest care.

In the present case, the ACPR criticised the company for failing to comply with its obligations to identify and verify the identity of its customers (in accordance with Article R. 561-10 of the Monetary and Financial Code), for not having a strengthened review mechanism (Article L. 561-10-2 of the Monetary and Financial Code), and for not having a sufficient asset freezing

mechanism (Article L. 562-4 of the Monetary and Financial Code). Finally, the ACPR criticised the lack of disclosure of the incorrect information.

In order to facilitate the implementation and understanding of the mechanism and measures to be taken under AML-CFT and the assets freeze, we remind you that several guides have been published by the ACPR and/or jointly with the Directorate General of the Treasury, including:

- guidelines on the implementation of asset freezing measures published in June 2016;
- guidelines for the identification, identity verification and customer knowledge published in December 2018; and
- guidelines on Politically Exposed Persons (PEP) published in May 2018.

French insurers facing the risk of climate change

The ACPR conducted a survey of all players in the climate insurance market in September 2018².

The report shows that while there is a broad consensus on the definition of climate change risk, the tools and methods developed by the organisations remain very heterogeneous and will evolve in the coming years. The multiple dimensions of climate change would, according to the ACPR, require new adaptations.

In its report, the regulator points out that insurance companies give priority, on the assets side of their balance sheets, to a measure of climate change risk determined by the carbon footprint of the business sector of their investments or by the Environmental, Social and Governance (ESG) rating of these investments.

On this point, the ACPR notes two particularities of the insurance sector. Indeed, unlike banks or asset managers, climate risk would not only affect the assets on the balance sheet but also the liabilities of insurance companies insofar as the risks associated with the increase in the frequency and cost of extreme weather events have direct consequences on the pricing of insurance policies and may ultimately raise the question of the insurability of certain risks, with possible implications for public policies. Secondly, the regulator points out that insurers' experience in climate risk management is more advanced than that developed by banks, with the regular use of severe stress tests.

² <https://acpr.banque-france.fr/les-assureurs-francais-face-au-risque-de-changement-climatique>

Taking into account the risk of climate change is a real challenge for French insurers as a potential factor for modifying or amplifying traditional risks. Thus, the ACPR notes that only less than a third of the organisations that responded to the survey (28%) report that they do not have a definition of climate change risks or a specific process in place.

The definition of climate risk also seems to be a matter of consensus among professionals. Thus, almost all insurers with an internal definition of these risks have adopted the classification based on the three main categories set out by Bank of England Governor Mark Carney in a speech at Lloyd's London in September 2015, namely physical risks, transition risks and liability risks.

The ACPR notes that monitoring of the risks associated with climate change to which insurers are exposed still needs to be further developed. It thus recommends the development of dedicated expertise and the transversal mobilization of human resources, which would require the implementation of specific governance.

Regarding the measurement of climate change risks on assets, the ACPR points out that stakeholders have a good knowledge of the carbon footprint of the asset portfolio, and that the identification and measurement of investment exposure is most often carried out at the level of the sector of activity. Finally, it indicates that the main tools for measuring the materiality of these climate risks are the ESG rating, analytical identification and the carbon intensity of assets.

With regard to the measurement of climate change risks on liabilities, the ACPR report shows that these are directly related to the core business of non-life insurers. The survey of insurers shows that they all collect premiums in categories exposed to climate risk - i.e. personal, business and agricultural property damage, natural disasters, transport and construction property damage - measure and assess the exposure of their liability portfolio to climate change risk. In addition, climate scenarios would be preferred as tools for measuring the materiality of climate risks on liabilities.

In order to mitigate the impact of climate change risk, the ACPR notes that several measures are being taken by insurers:

- on assets: limitation of investments in "non-green" sectors and raising the awareness of asset managers;
- on liabilities: geographical policy, pricing adjustment and renewal of risky policies.

Finally, a reading of the reports relating to Article 173 of the Energy Transition Law for Green Growth allows the ACPR to identify some areas for improvement to better take into account and manage climate change risk among insurers. Thus, according to the regulatory authority:

- organisations should more precisely define their climate change risk management strategy;
- they would need to adapt their governance system on several points, in particular by defining and formalising the role and responsibility of governance bodies in monitoring climate change risks. Governance rules should establish the means and procedures implemented to monitor progress in achieving the selected objectives and their possible revision. Finally, organisations should fully develop and appropriate the metrics used in climate change risk assessment;
- insurers should use metrics to understand the risk of climate change and develop a true forward-looking analysis;
- the legislator wanted insurers' consideration of climate change risk to be accompanied by increased transparency requirements.

Compliance

A look back at a year of the GDPR

The 2018 activity report and the 2019 challenges of the CNIL show that the implementation of the GDPR has resulted in a significant increase in complaints addressed to the supervisory authority but also in an influx of requests for information from professionals on how to comply with this new framework. As a result, the number of visitors to the site almost doubled in one year to more than 8 million in 2018.

The CNIL explains the record number of complaints by the media effect of the GDPR and by increased public awareness. The CNIL received a record 11,077 complaints (+32.5% compared to 2017).

These complaints related to:

- the dissemination of data on the Internet. The purpose of the request was to request the deletion of data concerning them from the Internet;
- the marketing/commerce sector;
- banking and credit; and
- the health and social sector.

As a result, the CNIL carried out 310 inspections in 2018, including 204 on-the-spot inspections, 51 online, 51 on documents and 4 hearings, which is in line with what it had set itself when it announced its annual inspection programme for 2018. The activity report shows that in most cases, the simple intervention of the CNIL resulted in the organisation's compliance.

The CNIL report shows that the entry into force of the GDPR does not change the way in which CNIL controls are carried out. The CNIL thus continues to verify, on site, online or by hearing, the conformity of the processing of personal data with the provisions of the Data Protection Act and the GDPR. However, two new features were introduced when the Data Protection Act was amended on June 20, 2018. Indeed, the CNIL can now invite officials from other data protection authorities in the European Union to participate in controls on the French territory, and carry out online controls under an assumed identity.

The year 2018 was marked by a substantial increase in the number of formal notices made public. It adopted 48 formal notices, 13 of which were the subject of a publicity measure (5 letters in the insurance field for example) relating in particular to the misuse of the purpose of the processing operations for commercial prospecting purposes.

The CNIL specifies in its report that, more generally, the various formal notices adopted by the President of the CNIL follow:

- the investigation of complaints (19);
- the performance of controls based on complaints (19);
- missions carried out on the basis of the annual audit programme defined by the CNIL, or carried out at the initiative of the CNIL in connection with current events (60); and
- for the first time, a notification of a violation of personal data (2).

In addition, its restricted formation has imposed 11 penalties, including 10 financial penalties, 1 non-public warning and 1 dismissal.

This year, 7 financial penalties imposed by the restricted formation were related to breaches of personal data security. The sanctions adopted, however, concerned facts that occurred before the GDPR came into force.

While the CNIL's actions in 2018 focused mainly on the implementation of the GDPR, it states in its report that 2019 *"will be decisive to give credibility to the new legal framework and transform this ambitious European challenge into operational success"*. It stresses that it will focus its action on two main areas: education and deterrence, and specifies that it wishes to devote its action in 2019 to:

- a control strategy focused on complaints received to remain in direct contact with citizens' expectations. The controls will include the practical exercise of rights, which represents 73.8% of the complaints received; and
- controls on major themes that concern all sectors rather than processing: the distribution of responsibilities between subcontractors and principals, minors' data.

Contacts



Gilles Kolifrath
Lawyer, Partner
gkolifrath@kramerlevin.com



François Poudelet
Lawyer, Counsel
fpoudelet@kramerlevin.com



Eric David
Lawyer, Counsel
edavid@kramerlevin.com



Jérôme Blanchet
Lawyer, CFA level 2
jblanchet@kramerlevin.com



Linda Sharkey
Lawyer at the New York Bar
lsharkey@kramerlevin.com



Gaëlle Libouban
Lawyer
glibouban@kramerlevin.com