INTERNATIONAL ASSOCIATION OF YOUNG LAWYERS

General Report

Concerning the implementation of the BASEL III guidelines and the regulatory framework for Managers of Alternative Investment Funds

Banking, Finance and Capital Markets Law Commission

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1. Introduction

The topics of the questionnaire were the regulations with regard to Basel III as well as legal aspects with regard to Alternative Investment Funds. Both topics are subject to recently emerged innovative but also intense regulation. The regulation in both fields was initiated by the financial crises and the principal aim of both of them is to prevent the systematic risks that compromise the financial market. Both regulations are highly controversial.

A total of 12 national reports have been submitted. Since Basel III as well as the provisions with regard to AIFMs are regulated very similar in the EU/EEA, the following general report distinguishes between member states of the EU/EEA and third countries.

2. Basel III

2.1 In general

In December 2010, the Basel Committee on Banking Supervision introduced the framework and rules to strengthen global capital and liquidity rules called Basel III. These rules are a global standard on bank capital adequacy, stress testing and market liquidity risk. They aim to strengthen bank capital requirements by increasing bank liquidity and decreasing bank leverage. Basel III is considered to be a voluntary standard. Countries are basically free to decide whether they want to implement the standard and also to which extent the want to implement the standard.

2.2 Members of the EU/EEA

The European Union (EU) as well as the European Economic Area (EEA) have transposed the new global standards invented by the Basel III guidelines into the EU legal framework. The Capital Requirement Directive IV and the Regulation (EU 575/2013) on prudential requirements for credit institutions and investment firms entered into force on 17 July 2013. The regulation (CRR) is directly applicable with immediate effect and without any further implementation while the directive (CRD) needs to be transposed into the national law of each member state.

This so called European Single Rule Book aims to ensure a uniform application of the Basel III guidelines in all Member Stats of the EU/EEA. It is supposed to close regulatory loopholes and will thus contribute to a more effective functioning of the Single European Market. Therefore, the EU/EEA members do not have much scope of action with regard to the implementation of the Basel III guidelines. The implementation is widely governed by the provisions stated in the CRD and CRR.

Within the members of the EU/EEA differences concerning the implementation of the CRD/CRR-Package mostly appear with regard to the various transitional periods.

The EU Capital Regulation provides for a transitional period during 2014 allowing for lower capital requirements (4 % instead of 4.5 % for Common Equity Tier capital and 4.5 instead of 6 % for Tier Capital). Whilst some member states make use of this transitional period others opted for not making use of it and instead already requiring the envisaged and final capital requirements from 1 January 2014. Spain has opted not to make use of the transitional periods. So did Liechtenstein.

The CRD-Package provides that the Liquidity Coverage Ratio (LCR) will be introduced as planed on 1 January 2015 but the minimum requirement will be set at 60 % and will then arise 10 % each year to reach the full 100 % requirement in Janaury 2019. The french legislation e.g. specifies that banks must have, at all times, a liquidity coefficient at least equal to 100 %.

The CRD-IV foresees a certain amount of flexibility with regard to the time of the application of the counter cyclical buffer and the capital conservation buffer. The European norms provide that these capital buffers have to be 2.5 % on 1 January 2019.

Finland is making use of the flexibility under the CDR IV so that the transnational provisions in respect to the capital conservation buffer and the counter cyclical buffer will be fully applied as of 1 January 2015. Austria will gradually introduce the capital conversation buffer as well as the countercyclical capital buffer as of 1 January 2016. Liechtenstein will apply these buffers immediately after enacting the relevant provisions.

At the time of the submission of the national reports the stages of implementation were as follows

Austria	The CRD IV has already been transposed into national law. The respective provisions entered into force on 1 January 2014.
Finland	There is some delay in the implementation process of the CRD IV. The Draft Government Bill has not been given to the Finish Parliament yet.

France	Rules with regard to solvency ration are already in force. Rules with regard to liquidity ratio should be implemented at latest January 2016.
Liechtenstein	The legislative process to implement the CRD IV is in progress. Rules are expected to enter into force by the end of 2014.
Spain	The draft to implement the CRD was approved by the Spanish government in February 2014.

2.3 Third states

Countries who are not a member of the EU/EEA are also making huge efforts to implement the Basel III guidelines even though they are not directly obliged to do so due to a membership in a supranational organisation.

In Switzerland, Basel III is implemented following very similar transitory provisions as provided by Basel III itself. The capital conservation buffer will start to be applied in 2016. The ratio of 2.5 % coverage of risk weighted assets will be implemented progressively with increasing values from 2016 to 2018.

Japan has also implemented the Basel III guidelines in order to cooperate with the global efforts to facilitate the financial stability. Japan has an interesting approach. It is implementing a slightly modified version of the Basel III guidelines which strongly divides between banks with locally based activities and internationally acting banks. The capital requirements for domestic banks are slightly more relaxed than the original Basel III guidelines. This is considered to be justified by the limited scope of activities of the domestic banks. Japan will implement the counter cyclical buffer as well as the capital conservation buffer as of January 2018.

The United States are also implementing the Basel III guidelines. Especially the United States had to deal with serious opposition regarding the implementation of Basel III. A gross number of local banks opposed to the implementation of Basel III. In July 2014, the Federal Reserve Board of Governors finally approved the final rules for the implementation. These rules subsequently comply with the Basel III standard.

Lebanon is also making huge efforts in order to comply with international standards. Jordan has not yet implemented the Basel III guidelines.

At the time of the submission of the national reports the stages of implementation were as follows:

Lebanon	No delay in the process of implementation.
Japan	The implementation of the Basel III guidelines complies with the international schedule. The Japanese Basel III framework applies since March 31 2013.
Jordan	The central bank decided to postpone the implementation of Basel III in 2011. In 2013 the central bank decided to amend the process of the minority interest of the capital in light of the implementation of Basle II guidelines.
Switzerland	The legislative changes have been completed by January 2013.
USA	In July 2014, the Federal Reserve Board of Governors finally approved the final rules for the implementation of Basel III.

2.4 Meeting the requirements

All national reporters were optimistic that the banks in their country will be able to meet the respective requirements. Although, banks in some countries still have to make considerable efforts. However, there is the general fear that banks face additional problems such as the administrative burdens. Further struggles might also be faced by smaller banks, such as the need to boost human resources and IT personnel.

2.5 Conclusion

The Basel III guidelines are considered to be a global minimum standard with regard to capital requirements. All national reports clearly outline the huge efforts of most countries to implement the Basel III guidelines in order to strengthen the stability of the financial system. This stability of the financial system is supposed to be achieved by strengthen bank capital requirements, increasing bank liquidity and decreasing bank leverage.

None of the national reports indicates that any country refuses to implement the Basel III guidelines. Huge efforts are made to meet the respective requirements. The consistently positive attitude towards the Basel III guidelines is considered to be a result of the recent financial crisis. Authorities as well as the main players of the financial markets have learned their lesson. The crisis has shown the weaknesses of the financial systems and the Basel III guidelines intend to abolish them. It is enjoyable to see that the countries as well as the main players of the financial market are now acting together in order to prevent another financial crisis. However one must also see that meeting the Basel III standard puts pressure on the players of the financial market. They are likely to reduce profitability margins and the return on equity. Banks face further administrative burdens.

3. Regulatory Framework for Managers of Alternative Investment Funds

3.1 Members of the EU/EEA

Similar to Basel III, the framework with regard to Managers of Alternative Investment Funds is subject to the legislation of the EU/EEA. All member states of the EU/EEA are obliged to implement the AIFM directive 2011/61/EU. The EU/EEA has therefore created a European Single Rule Book with regard to this matter.

The framework which is set out in the AIFM directive 2011/61/EU is very detailed and complex. The countries which are obliged to implement the respective directive do not have much scope of action with regard to the implementation. Therefore, the different legislation of EU/EEA members with regard to Managers of Alternative Investment Funds are almost identical.

The AIFM directive 2011/61/EU is a direct reaction to the financial crisis. Its main aim is to strengthen the protection of investors. Managers of Alternative Investment Funds are subject to a unified system of authorisation. In return, they can benefit from the EU/EEA-Passport which is an admittance to market their products in all countries of the EU/EEA. Hence, the AIFM directive contributes the implementation of the Single European Market with regard to financial products.

While the EU member states already profit from the EU/EEA-Passport, there is a major delay with regard to this matter in the EEA. The EEA member states have to implement the AIFM directive 2011/61/EU into the EEA-Contract. Due to the different opinions and interests of the EEA member states the implementation of the AIFM directive 2011/61/EU into the EEA-Contract has not been conducted yet. The EEA member states can therefore not benefit form the EU/EEA passport at this time. The duration of this delay is currently not appreciable.

3.2 Third states

Switzerland who is not a member of the EU/EEA is not obliged to transpose the AIFM directive 2011/61/EU. However, third country provisions in the AIFM directive 2011/61/EU considering equivalency of regulations affect Switzerland as well. It is in the interest of Switzerland as third country to develop equivalent regulations which enable Swiss based investment schemes to be present on the EU market. According to the AFIM Directive, after a a transition period of to years (i.e. at the earliest in 2015), a harmonized passport regime for third countries becomes applicable. At this point, a non-EU AFIM should be able to request an EU-Passport. This only will be possible if the non-EU AIFM is fully compliant with the AIFM Directive.

Japan has entered into the so called "Memorandum of corporation concerning consultation, cooperation and the exchange of information related to the supervision of funds and fund managers" with members of the EU/EEA, which implemented the AIFM directive 2011/61/EU.

There is an observable difference with regard to the regulatory approach between EU/EEA states and third countries. Compared to the EU/EAA third states do not focus that much on the regulation of the managers of investment funds. Instead they mainly regulate the investment funds itself.

4. General Conclusion

Both topics which have been subjects of the questionnaire show that there is a strong tendency of global harmonization with regard to financial market legal systems. This tendency is particularly strong within the EU/EEA. Differences between the systems fade away. This development results in a global market with lesser entry barriers. It is a matter of fact that the recent financial crises changed the view with regard to the necessity of global regulation of financial markets considerably. The future will show whether these regulations have the ability to prevent the financial system from crises like the recent one.