

## Financial Regulatory Developments Focus



### In this issue:

Derivatives

Compensation

Regulatory Capital

Financial Services

Financial Crime

**In this newsletter, we provide a snapshot of the principal European, US and global financial regulatory developments of interest to banks, investment firms, broker-dealers, market infrastructures, asset managers and corporates.**

Our latest quarterly Governance & Securities Law Focus newsletter is available at <http://www.shearman.com/~media/Files/NewsInsights/Publications/2014/04/Governance-and-Securities-Europe-Bulletin-CMAM-041014.pdf>.

### Derivatives

#### European Commission Consults on Definition of FX Financial Instruments

On 11 April 2014, the European Commission published a consultation paper on the definition of FX financial instruments. The consultation responds to concerns expressed about the lack of harmonization between EU Member States on the definitions of an FX financial instrument and a spot FX contract. The purpose of the consultation is to assist the Commission in preparing a formal proposal. The consultation includes 10 questions which range from the use of FX, settlement periods, developments in the FX market, risks, transitional periods and interaction with regimes outside of the EU. Responses to the consultation are due on 9 May 2014.

The consultation webpage is available at [http://ec.europa.eu/internal\\_market/consultations/2014/foreign-exchange/index\\_en.htm](http://ec.europa.eu/internal_market/consultations/2014/foreign-exchange/index_en.htm).

#### ESAs Consult on Draft RTS on Risk Mitigation for OTC Derivatives

On 14 April 2014, the Joint Committee of the European Supervisory Authorities (the “ESAs”) launched a consultation on draft regulatory technical standards (“RTS”) on risk mitigation for OTC derivatives as required under the European Market Infrastructure Regulation (“EMIR”). EMIR requires parties to derivative contracts that are not cleared through a central counterparty to use risk mitigation techniques. The draft RTS set out risk management procedures for the timely, accurate and appropriately segregated exchange of collateral, procedures for intragroup exemptions and the criteria for identifying practical and legal impediments to the prompt transfer of funds between counterparties.

Responses to the consultation are due by 14 July 2014. The ESAs will prepare final draft RTS for submission to the European Commission by the end of 2014. It is proposed that the RTS will enter into force on 1 December 2015, with a phase-in period of four years to mitigate the impact on liquidity. It is intended that the requirements will apply to market participants with an aggregate month-end average notional amount of OTC derivatives exceeding EUR3 trillion from that date. From 1 December 2019 the requirements would apply to any counterparty which is part of a group whose aggregate month-end average notional amount of OTC derivatives exceeds EUR8 billion.

The consultation paper is available at:

<http://www.eba.europa.eu/documents/10180/655149/JC+CP+2014+03+%28CP+on+risk+mitigation+for+OTC+derivatives%29.pdf>.

#### **CFTC Provides Conditional No-Action Relief for Swaps Trading on MTFs**

On 9 April 2014, the Commodity Futures Trading Commission's ("CFTC") Divisions of Market Oversight ("DMO") and Swap Dealer and Intermediary Oversight ("DSIO") announced the joint issuance of CFTC No-Action Letter No. 14-46 ("No-Action Letter 14-46") which provides no-action relief for (1) qualifying Multilateral Trading Facilities ("MTFs") from the swap execution facility ("SEF") registration requirement; (2) parties executing swap transactions on qualifying MTFs from the trade execution mandate; and (3) swap dealers and major swap participants executing swap transactions on qualifying MTFs from certain business conduct requirements. No-Action Letter 14-46 replaces and clarifies previous no-action relief granted by CFTC No-Action Letter No. 14-16, issued by the DMO and DSIO on 12 February 2014.

The CFTC no-action letter is available at:

<http://www.cftc.gov/ucm/groups/public/@llettergeneral/documents/letter/14-46.pdf>.

#### **FSB Provides Update on Implementation of OTC Derivatives Reforms**

On 8 April 2014, the Financial Stability Board ("FSB") published its seventh semi-annual progress report on the implementation of OTC derivatives market reforms. The report indicates that some jurisdictions still need to implement final legislation although the key issue is that regulatory authorities need to provide clarity on their processes for comparing regimes for equivalence purposes and to continue to work together to resolve conflicting requirements.

The FSB report is available at:

[http://www.financialstabilityboard.org/publications/r\\_140408.pdf](http://www.financialstabilityboard.org/publications/r_140408.pdf).

## Compensation

### EBA Consults on Revisions to Guidelines on Data Collection on High Earners and Remuneration Benchmarking

The European Banking Authority (“EBA”) published for consultation draft revised guidelines on the remuneration benchmarking exercise and the data collection exercise for high earners. Under CRD IV (comprised of the Capital Requirements Regulation and the Capital Requirements Directive), national EU regulators must provide data collected from individual firms to the EBA relating to remuneration levels and components of remuneration. The new requirements under CRD IV, which came into force on 1 January 2014, require regulators to collect more granular information than required under the previous European capital requirements legislation. Therefore, the EBA is consulting on proposed revisions to its guidelines and templates to account for the differences. The deadline for submission of responses is 7 May 2014.

The consultation paper on high earners is available at:

<http://www.eba.europa.eu/documents/10180/650888/EBA-CP-2014-05+%28CP+on+GL+on+the+data+collection+regarding+high+earnerns%29.pdf>.

The consultation on the remuneration benchmarking exercise is available at:

<http://www.eba.europa.eu/documents/10180/650835/EBA-CP-2014-04+%28CP+on+GL+on+the+remuneration+benchmarking+exercise%29.pdf>.

### PRA Clarifies Procedures for Firms to Increase the Fixed to Variable Ratio Limit

On 8 April 2014, the Prudential Regulation Authority (“PRA”) wrote to firms to provide clarity on the PRA’s view of the procedures to be followed when a firm wishes to increase the permitted ratio of fixed to variable ratio above the 1:1 limit. The letter indicates how thresholds should be calculated, how votes should be accounted for and the information necessary firms must provide to shareholders. The PRA also confirms that any staff affected by the higher maximum levels of variable remuneration are not permitted to exercise any voting rights they may have.

The PRA’s letter is available at:

<http://www.bankofengland.co.uk/pradocuments/supervision/remuneration/remunerationcap.pdf>.

## Regulatory Capital

### Federal Agencies Adopt Enhanced Supplementary Leverage Ratio Final Rule

On 8 April 2014, the Board of Governors of the Federal Reserve System (“Federal Reserve Board”), the Federal Deposit Insurance Corporation (“FDIC”), and the Office of the Comptroller of the Currency (“OCC”) adopted a final rule to strengthen the leverage ratio standards for the largest, most interconnected U.S. banking organizations. The final rule applies to U.S. top-tier bank holding companies with more than \$700 billion in consolidated total assets or more than

\$10 trillion in assets under custody (“covered BHCs”) and their insured depository institution (“IDI”) subsidiaries.

Covered BHCs must maintain a leverage buffer greater than two percentage points above the minimum supplementary leverage ratio requirement of three percent, for a total of more than five percent, to avoid restrictions on capital distributions and discretionary bonus payments. IDI subsidiaries of covered BHCs must maintain at least a 6 percent supplementary leverage ratio to be considered “well capitalized” under the agencies’ prompt corrective action framework. The final rule, which has an effective date of 1 January 2018, currently applies to eight large U.S. banking organizations that meet the size thresholds and their IDI subsidiaries. The final rule is substantively the same as the rule proposed by the banking agencies in July 2013.

The final rule is available at: [http://www.fdic.gov/news/board/2014/2014-04-08\\_notice\\_dis\\_a\\_fr.pdf](http://www.fdic.gov/news/board/2014/2014-04-08_notice_dis_a_fr.pdf).

#### **Federal Agencies Issue Supplementary Leverage Ratio Notice of Proposed Rulemaking**

On 8 April 2014, the Federal Reserve Board, the FDIC and the OCC issued a notice of proposed rulemaking (“NPR”) that would modify the denominator calculation for the supplementary leverage ratio in a manner consistent with recent changes agreed to by the Basel Committee on Banking Supervision. The revisions in the NPR would apply to all internationally active banking organizations, including those subject to the enhanced supplementary leverage ratio final rule.

Concurrently, the Federal Reserve Board, the FDIC and the OCC also issued a separate NPR proposing a technical correction to the definition of “eligible guarantee” in the agencies’ risk-based capital rules.

Comments on both NPRs will be welcomed through 13 June 2014.

The notices of proposed rulemaking are available at: [http://www.fdic.gov/news/board/2014/2014-04-08\\_notice\\_dis\\_b\\_fr.pdf](http://www.fdic.gov/news/board/2014/2014-04-08_notice_dis_b_fr.pdf).

#### **Basel Committee Publishes Final Standard on Capital Requirements for Exposures to CCPs**

On 10 April 2014, the Basel Committee on Banking Standards published the final standards for capital requirements for bank exposures to central counterparties. The interim framework was published in July 2012. The final standard will apply from 1 January 2017 with the interim provisions continuing to apply in the meantime. The final standard includes the following revisions to the interim standard:

- A new approach for determining the capital requirements for bank exposures to qualifying CCPs (“QCCPs”);
- A cap on the capital charges applied to bank exposures to QCCPs; and
- A specification of the treatment for “multi-level” client structures (i.e. a structure in which banks centrally clear as indirect clients).

The final standard is available at: <http://www.bis.org/publ/bcbs282.pdf>.

## Financial Services

### EU Adopts Market Abuse Legislation

On 14 April 2014, the Council of the European Union announced that it had adopted new European legislation on insider dealing and market abuse. The new legislation is made up of a regulation to enhance the protection of investors by extending the scope of the current market abuse directive (which will be replaced) to include financial instruments traded on all types of trading platforms as well as OTC-traded instruments, and a directive which establishes a framework for criminal sanctions for market participants that are caught abusing the markets. It is expected that the new legislation will be published in the Official Journal of the European Union in June. Following that, the European Commission will have two years to adopt implementing Level 2 legislation under the Regulation and member states will have to transpose the Directive into national law within the same period.

The press release is available at:

[http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ecofin/142206.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/142206.pdf).

### Regulators' Code Comes into Effect

On 6 April 2014, the UK's new Regulators' Code came into force. The Code was first published in July 2013. A range of regulators are subject to the Code, including the PRA and the Financial Conduct Authority. Regulators subject to the Code are obliged to take it into account when setting standards and giving guidance to the relevant regulated entities. The Government will monitor the effectiveness of the Regulators' Code and encourages businesses, regulated entities and individuals to challenge any regulator that does not appear to be acting in accordance with their published policies and standards.

The Regulators' Code is available at:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/300126/14-705-regulators-code.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/300126/14-705-regulators-code.pdf).

### FSB Publishes Papers on Risk Culture and Enhanced Supervision

On 7 April 2014, the FSB published guidance on supervisory interaction with financial institutions on risk culture and a progress report on supervisory intensity and effectiveness. The guidance identifies factors which contribute to the promotion of a sound risk culture, provides some indicators of a sound risk culture and provides guidance for supervisors to assess how sound and effective a financial institution's risk culture is. The progress report on enhanced supervision sets out the work already done in this area and remaining work to be done, such as strengthening risk management and measurement and improving stress testing, resources and modeling.

The guidance on risk culture is available at:

<http://www.financialstabilityboard.org/publications/140407.pdf>.

The paper on enhanced supervision is available at:

[http://www.financialstabilityboard.org/publications/r\\_140407.pdf](http://www.financialstabilityboard.org/publications/r_140407.pdf).

## Financial Crime

### SEC Charges Hewlett-Packard with FCPA Violations

On 9 April 2014, the Securities and Exchange Commission (“SEC”) charged Hewlett-Packard with violating the Foreign Corrupt Practices Act (“FCPA”) when its subsidiaries in three different countries made improper payments to government officials to obtain or retain lucrative public contracts. The SEC order finds that the schemes were executed through various Hewlett-Packard subsidiaries over the course of several years. Hewlett-Packard has agreed to pay more than \$108 million to settle the SEC’s charges.

The full text of the SEC order is available at:

<http://www.sec.gov/litigation/admin/2014/34-71916.pdf>.

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