



Financial Regulatory Developments Focus

In this week’s newsletter, we provide a snapshot of the principal US, European and global financial regulatory developments of interest to banks, investment firms, broker dealers, market infrastructure providers, asset managers and corporates.

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Bank Prudential Regulation & Regulatory Capital

US Federal Reserve Board Implements Changes to the Name Check Process for Domestic and International Banking Applications

On June 25, 2015, the Federal Reserve Board issued a supervisory letter implementing changes to the “name check” process for banking applications. Under the previous process, a name check was conducted on all proposed officers and/or new principle shareholders of a supervised financial institution involved in an application under consideration by the Federal Reserve Board. The new name check process will only be conducted for individuals that will become principal shareholders or one of the top two policymakers of the organization upon consummation of the process. In the case of a group acting in concert, name checks generally will be initiated on all individual group members with five percent or greater individual ownership interests. A completed name check will remain current for five years; individuals and companies with current name checks will generally not be rechecked unless circumstances indicate otherwise. In addition, the Federal Reserve Board will obtain credit bureau reports in certain limited situations to supplement and corroborate financial information provided in the application process. The guidance is applicable to all financial institutions supervised by the Federal Reserve Board, including those with \$10 billion or less in consolidated assets.

The Federal Reserve Board supervisory letter is available at:

<http://www.federalreserve.gov/bankinforeg/srletters/sr1508.htm>.

US Federal Reserve Board Grants Financial Holding Company Status to South Korea-Based Company and Subsidiary

On June 18, 2015, the US Board of Governors of the Federal Reserve System issued a letter granting Financial Holding Company status to KB Financial Group, Inc. and its subsidiary, Kookmin Bank, both of Seoul, South Korea. KB Financial Group and Kookmin Bank are each foreign banking organizations under the Bank Holding Company Act. In acting on their FHC elections, the Federal Reserve Board determined that KB Financial Group, Inc. and Kookmin Bank are well capitalized and well managed under standards comparable to those applied to US companies seeking to be FHCs and that they are subject to comprehensive supervision on a consolidated basis.

The Federal Reserve Board letter is available at:

http://www.federalreserve.gov/bankinforeg/LegalInterpretations/bhc_changeincontrol20150618a1.pdf.

US Regulatory Agencies Issue Host State Loan-to-Deposit Ratios

On June 29, 2015, the Federal Reserve Board, the US Federal Deposit Insurance Corporation and the US Office of the Comptroller of the Currency issued the host state loan-to-deposit ratios that they will use to determine compliance with section 109 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.

Section 109 generally prohibits a bank from establishing or acquiring a branch or branches outside of its home state primarily for the purpose of deposit production. In addition, it also prohibits branches of banks controlled by out-of-state bank holding companies from operating primarily for the purpose of deposit production.

Section 109 delivers a multi-step process to test compliance with the statutory requirements. The first step involves a loan-to-deposit ratio screen that compares a bank’s statewide loan-to-deposit ratio to the host state loan-to-deposit ratio for banks in a particular state. A second step is conducted if a bank’s statewide loan-to-deposit ratio is less than one-half of the published ratio for that state or if data is not available at the bank to conduct the first step. The second step requires the appropriate agency to determine whether the bank is reasonably helping to meet the credit needs of the communities served by the bank’s interstate branches. A bank that fails both steps is in violation of section 109 and is subject to sanctions by the appropriate agency. The most recently released ratios update data previously released on July 2, 2014.

The updated host state loan-to-deposit ratios are available at:

<http://www.occ.gov/news-issuances/news-releases/2015/nr-ia-2015-92a.pdf>.

Final Draft Implementing Technical Standards on Supervisory Reporting for Liquidity Coverage Ratio

On June 23, 2015, the European Banking Authority published its final draft Implementing Technical Standards under the Capital Requirements Regulation, amending the existing ITS on supervisory reporting on the Liquidity Coverage Ratio. The final draft

ITS make significant changes to the existing LCR reporting templates and a large number of new data items need to be introduced further to the requirements of the LCR delegated regulation published in the Official Journal of the European Union in January 2015. The changes include new templates and instructions for banks on capturing and reporting all necessary LCR items. The new templates cover liquid assets, outflows, inflows, collateral swaps and calculation of the LCR. The new instructions will only apply to banks – investment firms will continue to use current instructions and templates, at least for now.

The final draft ITS are available at:

<http://www.eba.europa.eu/regulation-and-policy/supervisory-reporting/implementing-technical-standards-amending-commission-implementing-regulation-eu-no-680/2014-with-regard-to-the-liquidity-coverage-ratio>.

European Systemic Risk Board Publishes Recommendations on Misconduct Risk

On June 25, 2015, the European Systemic Risk Board published a report on misconduct risk in the banking sector. The report analyses misconduct risk in the banking sector from a macroprudential angle and makes the following recommendations:

(i) prudential and conduct regulators should continue to impose requirements on banks that limit the opportunities for misconduct; (ii) coordination and transparency between regulators at an international level should be improved, including preparation of a set of principles for authorities to follow where action against a bank in one jurisdiction may have systemic implications in another jurisdiction; (iii) extension of the legal entity identifier scheme to a wider range of counterparties so that banks can determine which entities are subject to financial sanctions; (iv) the European Supervisory Review and Evaluation Process taking into account the systemic impact of potential misconduct; and (v) inclusion of potential misconduct risks in future EU-wide stress tests.

The report is available at:

http://www.esrb.europa.eu/pub/pdf/other/150625_report_misconduct_risk.en.pdf.

Compensation

UK Regulators Publish Further New Rules on Remuneration

On June 23, 2015, the Prudential Regulation Authority and Financial Conduct Authority issued a joint Policy Statement on new remuneration rules to strengthen the alignment of risk and reward, encouraging more effective risk management and discouraging excessive risk taking. The changes to the PRA Rulebook and FCA Handbook will apply to banks, building societies, PRA-designated investment firms as well as UK branches of non-EEA headquartered firms. The new rules apply to all Material Risk Takers and Senior Managers covered by the incoming Senior Managers Regime which takes effect next year. The changes include: (i) extending deferral periods for Senior Managers to no less than seven years, with no vesting period prior to the third anniversary of the award and vesting no faster than on a *pro-rata* basis; (ii) extending deferral periods for all other MRTs to no less than five years, with vesting no faster than *pro-rata* from one year (PRA only requirement); (iii) clarifying the rule that no variable remuneration should be paid to the management body of a firm which receives exceptional government support unless justified – the rule applies to all discretionary payments, including payment for loss of office and discretionary pension benefits and applies to firms in receipt of exceptional governmental support whether by direct support or a guarantee but will not apply to firms which receive emergency liquidity assistance; (iv) a new FCA rule requiring firms to apply clawback where there is misconduct or risk management failures up to seven years from the date of a variable remuneration award (the PRA implemented the same rule from January 1, 2015); and (v) extending the clawback period by up to three years, in addition to the seven years for PRA-designated Senior Managers where there are outstanding internal or regulatory investigations at the end of the normal seven-year clawback period. The final rules on clawback and deferrals will apply to variable remuneration awarded for performance periods beginning on or after January 1, 2016. The remainder of the new rules will apply from July 1, 2015. The PRA also published a new Supervisory Statement on remuneration which supplements its existing statements on remuneration standards. The Supervisory Statement clarifies the objectives of the PRA and sets out the expectations of firms relating to proportionality, remuneration structures, risk management and control functions. The FCA published guidance on the application of malus to ex-post risk adjustment and variable remuneration as well as guidance on proportionality for dual-regulated PRA and FCA firms.

The Policy Statement, Supervisory Statement and guidance documents are available at:

<http://www.bankofengland.co.uk/pr/ Documents/publications/ps/2015/ps1215.pdf>;

<http://www.bankofengland.co.uk/pr/ Documents/publications/ss/2015/ss2715.pdf>;

<http://www.fca.org.uk/static/documents/finalised-guidance/guidance-dual-regulated-firms-remuneration-code.pdf>; and

<http://www.fca.org.uk/static/documents/finalised-guidance/guidance-on-ex-post-risk-adjustment-variable-remuneration.pdf>.

Credit Ratings

European Guidelines on Periodic Information Reporting Requirements for Credit Rating Agencies

The final guidelines on periodic information to be submitted by Credit Rating Agencies to the European Securities and Markets Authority were published on June 23, 2015. The guidelines apply to CRAs registered in the EU, but not to certified CRAs. They set out the information that CRAs should submit to ESMA on a quarterly, semi-annual and annual basis, including for the calculation by ESMA of supervisory fees and CRA market share. The guidelines will apply from August 23, 2015.

The final guidelines are available at:

<http://www.esma.europa.eu/content/Guidelines-periodic-information-be-submitted-ESMA-Credit-Rating-Agencies-0>.

European Securities and Markets Authority Issues Public Notice to European Credit Rating Agency

On June 29, 2015, ESMA issued a public notice to EU credit rating agency DBRS Ratings Limited for failing to comply with corporate governance, compliance and record-keeping requirements under the EU Credit Rating Agencies Regulation. ESMA found DBRS to have governance arrangements whereby the board of directors and a body called the Executive Group worked alongside one another. There was however no delegation by the directors to the Executive Group and the two bodies did not report to each other. ESMA also found that DBRS failed to have adequate policies or maintain decision-making procedures and organizational structures which clearly specified responsibilities and reporting lines. DBRS was fined €30,000 for acting negligently in record-keeping failings.

The public notice is available at:

<http://www.esma.europa.eu/content/Public-Notice-ESMA-fines-DBRS-Ratings-Limited>.

Derivatives

US Commodity Futures Trading Commission Issues Proposed Rule on Cross-Border Margin

On June 29, 2015, the US Commodity Futures Trading Commission voted unanimously to propose a rule that would apply the CFTC's margin requirements for uncleared swaps under the framework of cross-border transactions. The proposed rule would apply to CFTC-registered swap dealers and major swap participants (recognized collectively as "covered swap entities") that are not subject to the margin requirements of other prudential regulators such as the Federal Reserve Board, OCC or the FDIC. Under the proposed rule, covered swap entities would be required to comply with the CFTC's margin rules for all uncleared swaps in cross-border transactions, with a limited exclusion. In addition, the proposed rule would allow for substituted compliance, which permits covered swap entities to comply with comparable margin requirements in a foreign jurisdiction as an alternative means of complying with the CFTC's margin rules for uncleared swaps. The comment period ends 60 days after the publication in the Federal Register.

The press release, proposed rule and factsheet are available at:

<http://www.cftc.gov/PressRoom/PressReleases/pr7192-15>;

<http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister062915.pdf>; and

http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/crossborder_factsheet062915.pdf.

Financial Market Infrastructure

Payments Systems Regulator Issued Call for Input on Card Payment Systems

On June 24, 2015, the Payment Systems Regulator issued a call for input on card payment systems. The PSR seeks views on issues related to payment systems in the UK and in particular on interbank payment systems. The PSR is interested in hearing

about the impact of new EU regulations which introduce new rules and implement caps on interchange fees, and the effect that these regulations might have on the way in which the UK card payment systems operate. The call for input also wishes to obtain views on general trends within card payment systems and gather information on how the interests of service users are considered in decision making. Responses to the call for input are due before July 31, 2015.

The call for input is available at:

<https://www.psr.org.uk/sites/default/files/media/PDF/Cards%20Call%20for%20Inputs.pdf>.

Financial Services

UK Regulators Propose New Rules for Regulating Credit Unions

On June 24, 2015, the PRA and the FCA launched a consultation on proposals to reform the Credit Unions Sourcebook in the Handbook. The PRA intends to replace the current Credit Unions Sourcebook that was inherited from the FSA with a new Credit Unions Rulebook in the PRA Rulebook which will focus on the safety and soundness of credit unions and will reflect the now broader range of financial services offered by credit unions. The FCA intends to replicate many of the provisions of the Credit Unions Sourcebook. The consultation closes on September 30, 2015.

The consultation paper is available at:

<http://www.bankofengland.co.uk/pr/Documents/publications/cp/2015/cp2215.pdf>.

UK Regulator Publishes Discussion Paper on Delivering Smarter Communications to Consumers

On June 25, 2015, the FCA issued an interactive discussion paper to start a debate and encourage firms to deliver smarter communications to consumers in more effective ways. The discussion paper states that for a market to perform well, engaged and informed consumers are needed. The FCA recognizes that some methods of communication can overwhelm, confuse and even deter consumers from making effective choices about financial products and services. The FCA is committed to ensuring that firms operate with due regard for their consumers, that communications are not misleading and that communications are transmitted in a clear and fair way. The FCA also published research alongside the discussion paper. Responses to the discussion paper are due by September 25, 2015.

The discussion paper and research are available at:

http://www.fca.org.uk/static/channel-page/dp-smarter-comms/dp-smarter-comms.html?utm_source=smarter-comms&utm_medium=smarter-comms&utm_campaign=smarter-comms.

Funds

Proposals Published for Updating the 2004 Report on International Regulatory Standards on Fees and Expenses

On June 25, 2015, the International Organization of Securities Commissions published proposed recommendations and statements of practice on fees and expenses of investment funds. The recommendations and statements of practice are intended to update the 2004 report on International Regulatory Standards on Fees and Expenses which provided a set of international standards of best practice for collective investment schemes and regulators to consider. The proposed recommendations and statements of practice cover issues such as types of permitted fees and expenses, performance-related fees, disclosure of fees and expenses, transaction costs and hard and soft commissions on transactions. The report is aimed at funds whose shares or units may be sold to retail investors and includes open-ended funds, closed-ended funds whose shares are traded in the securities market, unit investment trusts and contractual models. The proposals are open for comment until September 23, 2015.

The report is available at:

<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD491.pdf>.

People

John Roeser Named Associate Director of the US Securities and Exchange Commission Office of Market Supervision

On June 25, 2015, the US Securities and Exchange Commission announced the appointment of John C. Roeser to Associate Director and deputy head of the SEC's Office of Market Supervision in the SEC Division of Trading and Markets starting immediately.

European Securities and Markets Authority Board of Supervisors Appoints New Chairs of its Standing Committees

The Board of Supervisors of ESMA has appointed the following individuals as chairs of its standing committees: (i) Lourdes Centeno to chair the Review Panel; (ii) Hannelore Lausch to chair the Corporate Reporting Standing Committee; (iii) David Lawton to chair the Market Data Standing Committee; (iv) Elizabeth Roegele to chair the Secondary Markets Standing Committee; (v) Jean-Paul Servais to chair the Financial Innovation Standing Committee; and (vi) Martin Wheatley to chair the Investor Protection and Intermediaries Standing Committee.

Upcoming Events

July 2, 2015: EBA public hearing on methodologies for the valuation of derivative liabilities.

July 3, 2015: EBA workshop on proportionality measures for regulatory purposes.

July 6, 2015: EBA public hearing on assigning risk weights to specialized lending exposures.

July 8, 2015: Senate Committee on Banking, Housing and Urban Development hearing titled "The Role of the Financial Stability Board in the US Regulatory Framework."

July 15, 2015: CFTC Division of Market Oversight public roundtable to discuss the Commodity Exchange Act's trade execution requirement and the process of making Made Available to Trade determinations.

July 16 and 29, 2015: SEC outreach programs to aid firms in compliance with Regulation Systems Compliance and Integrity.

July 20, 2015: FCA Senior Managers and Certification Regime briefing for professional advisers.

July 22, 2015: FCA Annual Public Meeting 2015.

This newsletter is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired. If you wish to receive more information on the topics covered in this publication, you may contact your usual Shearman & Sterling representative or any of the following:

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