

Financial Regulatory Developments Focus



In this issue:

Derivatives
Bank Prudential Regulation &
Regulatory Capital
Recovery & Resolution

Financial Market
Infrastructure

Funds

Enforcement

People

Events

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.

Derivatives

CFTC Issues Extension of No-Action Relief Granted to Certain CDS Clearing-Related Swaps

On September 29, 2014, the US Commodity Futures Trading Commission's ("CFTC") Division of Market Oversight announced an extension of no-action relief previously granted on December 31, 2013, providing time-limited relief relating to certain occasional, off-facility, cleared credit default swaps ("CDS") entered into pursuant to a derivative clearing organization's rules related to its price submission process for determining end-of-day settlement prices for cleared CDSs ("CDS Settlement Price Process"). Under the no-action letter, the CFTC will not commence an enforcement action against any clearing member of a derivative clearing organization for entering into a swap through the CDS Settlement Price Process and not through a swap execution facility or a designated contract market. In addition, counterparties for such swaps will be relieved of their obligation to report swap data under the CFTC no-action letter. The extension of the no-action relief will expire on September 30, 2015.

The full text of the CFTC no-action letter is available at:

<http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/14-119.pdf>.

CFTC Announces that Swap Dealers and Major Swap Participants May Furnish Risk Exposure Reports to the Commission through WinJammer

On September 29, 2014, the CFTC's Division of Swap Dealer and Intermediary Oversight announced that Swap Dealers ("SDs") and Major Swap Participants ("MSPs") may furnish risk exposure reports to the CFTC through WinJammer, instead of filing via the CFTC's web portal. CFTC Regulation 23.600(c)(2)(ii) requires SDs and MSPs to furnish risk exposure reports to the CFTC. Today's announcement by the CFTC clarifies that, because risk exposure reports submitted by SDs and MSPs through WinJammer will be furnished to the CFTC automatically, SDs and MSPs are not required to re-submit the same risk exposure reports to the CFTC through the CFTC web portal.

Bank Prudential Regulation & Regulatory Capital

PRA Proposed Approach to Compliance with EBA Guidelines on Disclosure of Encumbered and Unencumbered Assets

On September 22, 2014, the Prudential Regulation Authority (“PRA”) published for consultation a draft supervisory statement on the European Banking Authority’s (“EBA”) Guidelines on Disclosure of Encumbered and Unencumbered Assets. The draft supervisory statement sets out the criteria for the PRA’s intended use of the waiver from the requirement to disclose collateral received that is kept off balance sheet (which would normally be disclosed by firms to the PRA using template B in the EBA Guidelines). The EBA Guidelines relate to the reporting requirements under the Capital Requirements Regulation. The Guidelines seek to address concerns that transparency regarding assets encumbered to central banks and liquidity assistance given by central banks may negatively impact financial stability. Under the EBA Guidelines, a national regulator may waive the requirement to disclose such collateral if such disclosure would allow the use or non-use of liquidity assistance to be detected. Under the PRA’s proposals, a PRA-supervised firm subject to the Capital Requirements Regulation and the Capital Requirements Directive will be able to make use of the waiver provided it meets the PRA’s criteria. The consultation paper also includes the PRA’s proposed expectations on factors to be considered and frequency of disclosures in compliance with the EBA Guidelines. Responses to the consultation are due by November 24, 2014.

The consultation paper is available at:

<http://www.bankofengland.co.uk/pr/Documents/publications/cp/2014/cp1814.pdf>.

FFIEC Warns of Security Vulnerabilities in Bourne-again Shell System Software

On September 26, 2014, the Federal Financial Institutions Examination Council (“FFIEC”) issued an alert notifying financial institutions of a material security vulnerability in Bourne-again shell system software that could allow attackers to gain access and control of operating systems. The FFIEC alert outlines the risks associated with the vulnerability (known as “Shellshock”) and advises financial institutions to take appropriate risk mitigation steps. Examples of appropriate risk mitigation steps include: (i) identifying vulnerable internal systems and services; (ii) following appropriate patch management practices; and (iii) ensuring that third-party vendors take appropriate risk mitigation steps and monitoring the status of the vendors’ efforts.

The full text of the FFIEC alert is available at:

http://www.ffiec.gov/press/PDF/FFIEC_JointStatement_BASH_Shellshock_Vulnerability.pdf.

OCC Issues Booklet on Federal Branches and Agencies Supervision

On September 26, 2014, the OCC issued the “Federal Branches and Agencies Supervision” booklet in order to provide updated guidance and examination procedures to both examiners and bankers on the supervision of federal branches

and agencies. The booklet also highlights special considerations arising from legal and operational structures that differentiate federal branches and agencies from national banks and addresses new and updated rules and guidance issued by other federal agencies.

The full text of the OCC booklet is available at:

<http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/pub-ch-ep-fbs.pdf>.

Banking Supervisors and Central Bankers Meet to Discuss Post-Crisis Reform Progress

On September 25, 2014, the Bank for International Settlements published a press release which summarizes the discussion on progress of post-crisis reforms at the meeting of banking supervisors and central bankers in China. The press release sets out next steps for dealing with globally systemically important banks, the net stable funding ratio (the final standard will be released in the coming weeks), revising corporate governance guidance, securitization standards and improving consistency in bank capital ratios.

The press release is available at: <http://www.bis.org/press/p140925.htm>.

Recovery & Resolution

Final Guidelines on Tests, Reviews or Exercises Potentially Leading to Support Measures

On September 22, 2014, the EBA published final Guidelines on the types of tests, reviews or exercise that would exempt an injection of own funds or acquisition of capital instruments from being considered a form of extraordinary public financial support under the Banking Recovery and Resolution Directive (the “BRRD”). Under the BRRD, a request by a bank for extraordinary public financial support is an indicator that the firm is failing or is likely to fail which will trigger resolution. However, in certain circumstances, such a request will not trigger resolution, including when an injection of own funds or an acquisition of a capital instrument is used to address a capital shortfall resulting from a stress test, an asset quality review or other equivalent exercises. The Guidelines apply to national regulators and aim to ensure a consistent application of the BRRD provisions across the EU. National regulators are required to implement the Guidelines by January 1, 2015.

The Guidelines are available at:

<http://www.eba.europa.eu/documents/10180/821335/EBA-GL-2014-09+%28Guidelines+on+Public+Support+Measures%29.pdf>.

EBA Consults on Proposed Guidelines on Minimum Indicators for Recovery Plans

On September 26, 2014, the EBA published a consultation on proposed guidelines which set out the minimum qualitative and quantitative indicators that a firm should include in its recovery plan, as required by the BRRD, for capital, liquidity, profitability and asset quality. A recovery plan will set out how a firm intends to restore financial viability in case of severe distress. The indicators will be used to identify when to trigger the process set out in the recovery plan to

assess which recovery actions should be taken. The consultation closes on January 2, 2015.

The consultation paper is available at: <http://www.eba.europa.eu/-/eba-consults-on-qualitative-and-quantitative-recovery-plan-indicators>.

EBA Consults on Eligibility Criteria for Simplified Obligations

On September 25, 2014, the EBA published two consultation papers on draft guidelines and draft implementing technical standards (“ITS”) relating to eligibility of firms for simplified obligations under the BRRD. The proposed guidelines expand upon the criteria in the BRRD for eligibility for simplified obligations, creating a list of mandatory and optional indicators for national regulators to use in their assessments of firms. The proposed guidelines also include clarification that any firm considered to be globally systemically important would not be suitable for the application of the simplified obligations. The proposed draft ITS establish templates and definitions for national regulators to use when transmitting information to the EBA about their assessments of firms against the eligibility criteria. Both consultations close on January 3, 2015.

The consultation papers are available at: <http://www.eba.europa.eu/-/eba-consults-on-the-eligibility-of-institutions-for-simplified-obligations-for-recovery-and-resolution-planning>.

EBA Consults on Resolution Tools under BRRD

On September 24, 2014, the EBA launched two consultations on draft guidelines under the BRRD relating to resolution tools. The first consultation paper sets out proposed guidelines on the minimum list of services or facilities that are necessary to enable a recipient to operate a business transferred to it under the BRRD. The services, which should ensure continuity of the transferred business, include services such as human resources support, information technology, cash handling, risk management and compliance services. The second consultation paper details proposed guidelines on the sale of business tool and on the asset separation tool. The proposed guidelines for the sale of business tool provide exemptions for national regulators from certain marketing requirements for the sale of a business where the failure of a firm would materially threaten financial stability. The draft guidelines on the asset separation tool set out the assets that may be transferred using this tool. Responses to both consultations are due by December 22, 2014.

The consultation papers are available at: http://www.eba.europa.eu/news-press/calendar?p_p_id=8&_8_struts_action=%2Fcalendar%2Fview_event&_8_eventId=825273 and at <http://www.eba.europa.eu/-/eba-consults-on-the-implementation-of-resolution-tools>.

EBA Consults on Guidance for Payment Commitments for Deposit Guarantee Schemes

On September 25, 2014, the EBA launched a consultation on proposed guidelines on payment commitments of firms subject to the Deposit Guarantee Schemes Directive (the “DGSD”). The DGSD requires each member state to set up a deposit guarantee scheme or schemes to be funded by *ex ante* and *ex post*

contributions of any credit institution subject to the Capital Requirements Regulation. The methods for financing a deposit guarantee scheme is harmonized under the DGSD, including by payment commitments of credit institutions which are fully collateralized. The EBA's proposed guidelines aim to ensure consistency in the application of the criteria and procedures around payment commitments so as to establish a level playing field, prevent regulatory arbitrage and promote legal clarity. The proposed guidelines are intended to provide firms and regulators with guidance on the legal instruments which deposit guarantee schemes and firms should enter regarding payment commitments as well as the eligibility and management of the collateral. The consultation is open until January 2, 2015.

The proposed guidelines are available at: http://www.eba.europa.eu/regulation-and-policy/recovery-and-resolution/guidelines-on-payment-commitments#paper_827196.

FSB Consults on Cross-Border Recognition for Resolution Action

The Financial Stability Board ("FSB") released a consultation, on September 29, 2014, on establishing an effective cross-border recognition framework for cross-border resolution. The FSB is proposing: (i) a set of elements for inclusion in statutory cross-border recognition frameworks; and (ii) contractual approaches to cross-border recognition including (a) temporary stays on early termination rights in financial contracts; and (b) bail-in of debt instruments. For temporary stays, the FSB paper states that the International Swaps and Derivatives Association has developed a draft protocol to its Master Agreement which would support the cross-border enforcement for OTC derivatives governed by the Master Agreement between adopting parties. The draft protocol is expected to be launched in the near future and an initial set of G-SIBs are expected to adhere to it by the end of October. It is intended that the adopted protocol would govern existing and new OTC derivatives contracts between adopting banks from January 2015. Other proposed methods for contractual measures are through the imposition by prudential regulators of rules requiring firms to adopt the necessary contractual language on stays in resolution with all their counterparties. Jurisdictions with the power to require firms to improve resolvability may require firms to do so through the use of contractual stay provisions. The FSB considers that through imposing direct requirements on regulated entities, unregulated firms will also be caught by the requirements.

The FSB also proposes key principles for the enforceability of bail-in of debt instruments, which principles are based on existing and emerging practices in some jurisdictions which already require contractual recognition clauses to be included in capital or debt instruments governed by foreign law, including, in certain jurisdictions, the requirement for firms to show to regulators that any statutory bail-in of such instrument would be enforceable. The FSB is proposing that regulators should require all entities issuing debt governed by the law of a foreign jurisdiction to include recognition clauses for statutory bail-in of those debt instruments.

The FSB intends to finalize guidance on key principles for recognition clauses as well as the core elements of statutory recognition frameworks by end-2015. FSB members are expected to take action to promote the adoption of contractual clauses recognizing stays on early termination rights and exercise of bail-in powers by end-2015. Responses to the consultation are due by December 1, 2014.

The FSB paper is available at:

http://www.financialstabilityboard.org/publications/c_140929.pdf.

Financial Market Infrastructure

UK Government Consults on Broadening the Benchmark Regulatory Perimeter

On September 25, 2014, the UK Government launched a consultation on the first set of recommendations from the Fair and Effective Markets Review, which recommended that additional major financial benchmarks should be brought into the regulatory framework for benchmark administrators. The Fair and Effective Markets Review is led by the Bank of England, the Financial Conduct Authority (“FCA”) and HM Treasury. The final report of the Review is due to be published in June 2015. The benchmarks proposed for inclusion in the UK regulatory perimeter are Sterling Overnight Index Average, Repurchase Overnight Index Average, WM/Reuters’ FX benchmark rates, ISDAFix, ICE Brent Futures, LBMA Silver Price and the London Gold Fix. There are three criteria for benchmarks to be included in the UK regime, which are: (i) the benchmark must be a major benchmark, which means that it is one that has the greatest usage within the main fixed-income, currency and commodity product markets; (ii) the main benchmark administration activities must be located in the UK; and (iii) the benchmark is based on transactions in financial instruments which are not covered comprehensively by existing market abuse regulation. The consultation closes on October 23, 2014.

The consultation paper and other information is available at:

<https://www.gov.uk/government/consultations/fair-and-effective-market-reviews-benchmarks-to-bring-into-uk-regulatory-scope>.

Funds

ESMA Consults on Draft Technical Advice on Role of Depositories for UCITS

On September 26, 2014, the European Securities and Markets Authority (“ESMA”) published a consultation paper on draft technical advice on the role of depositories under the revised Undertakings for Collective Investments in Securities (“UCITS”) Directive (“UCITS V”). ESMA is seeking views on: (i) proposed steps to be taken by a third party to ensure that any assets held in custody by it on behalf of a UCITS are unavailable for insolvency distribution; and (ii) independence requirements for a UCITS management company and its depository. The consultation is open until October 24, 2014. ESMA intends to use

the feedback to inform its technical advice to the European Commission, which is to be provided by the end of November 2014.

The consultation paper is available at:

<http://www.esma.europa.eu/consultation/Consultation-delegated-acts-required-UCITS-V-Directive>.

ESMA Consults on Draft Technical Advice on Social Entrepreneurship and Venture Capital Funds

On September 26, 2014, ESMA published a consultation paper on draft technical advice to the European Commission due under the European Social Entrepreneurship Funds (“EuSEF”) Regulation and the European Venture Capital Funds (“EuVECA”) Regulation. The consultation paper covers the following topics: (i) the types of good and services, methods of production for goods and services and financial support representing a social objective; (ii) conflicts of interest of EuSEF and EuVECA managers; (iii) methods for measurement of the social impact; and (iv) information that EuSEF managers should provide to investors. The consultation is open until December 10, 2014. ESMA intends to submit its final technical advice to the European Commission by the end of April 2015.

The consultation paper is available at:

<http://www.esma.europa.eu/consultation/Consultation-implementing-measures-Regulations-EuSEF-and-EuVECA>.

Enforcement

EBA Investigates Potential Breach of EU Law in Bulgaria

On September 25, 2014, the EBA announced that it had begun an investigation into an alleged breach of European Union law by national regulators in the Republic of Bulgaria. It is alleged that the regulators may have breached requirements under the Deposit Guarantee Scheme Directive that depositors should be compensated no later than 25 working days after the unavailability of deposits.

The EBA’s announcement is available at: <http://www.eba.europa.eu/-/eba-investigates-possible-breach-of-eu-law-in-bulgaria>.

Barclays Bank Plc Fined for Client Asset Failures

On September 23, 2014, the UK FCA announced that it had fined Barclays Bank Plc £37,745,000 for breach of the FCA’s Client Asset Rules as well as the requirements that a firm should have adequate management, systems and controls in place and should properly safeguard a client’s assets. The fine is the largest fine imposed by the FCA (or its predecessor, the Financial Services Authority) for a breach of the Client Asset Rules.

The announcement is available at: <http://www.fca.org.uk/news/barclays-fined-38-million-for-putting-16-5-billion-of-client-assets-at-risk>.

OCC Penalizes US Bank National Association for Unfair Billing Practices

On September 25, 2014, the OCC announced a \$4 million civil monetary penalty against US Bank National Association in Cincinnati, Ohio and ordered restitution of \$47.9 million to more than 420,000 consumer accounts. The OCC enforcement action, made in coordination with the Consumer Financial Protection Bureau (“CFPB”), found that the bank’s practices violated the Federal Trade Commission Act, prohibiting unfair acts or practices. Among those consumers eligible for restitution are those who were unfairly billed for identity theft protection products marketed by the bank and sold by its vendor. The restitution will include the full amount paid for these products, plus any associated over-limit fees and finance charges. In addition, the OCC order requires the bank to improve its governance of third-party vendors associated with “add-on” consumer products and to submit to the OCC a third-party management program plan for add-on consumer products marketed or sold by the bank or its vendors.

In the coordinating action, the CFPB issued a separate order against the bank based on unfair billing for identity theft protection products. The CFPB order required the bank to pay a \$5 million civil money penalty and ordered restitution to harmed consumers.

The full text of the OCC enforcement order is available at:

<http://occ.gov/static/enforcement-actions/ea2014-115.pdf>.

The full text of the CFPB consent order is available at:

http://files.consumerfinance.gov/f/201409_cfpb_consent-order_us-bank.pdf.

People

SEC Appoints New Director of Atlanta Regional Office

On September 23, 2014, the Securities and Exchange Commission (“SEC”) announced the appointment of Liban Jama as the director of the SEC’s Atlanta Regional Office.

SEC Appoints New Senior Counsel to OCIE Director

On September 23, the SEC announced that Rhea Dignam was named as Senior Counsel to the Director of the Office of Compliance Inspections and Examinations.

Events

November 21, 2014: EBA public hearing on payment commitments for financing of deposit guarantee schemes.

November 28, 2014: EBA public hearing on implementation of resolution tools.

October 9, 2014: CFTC Global Markets Advisory Committee will hold a public meeting on issues related to clearing Non-Deliverable Forwards and the digital currency bitcoin.

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:

EUROPE

BARNEY REYNOLDS

T: +44 20 7655 5528

barney.reynolds@shearman.com

London

AZAD ALI

T: +44 20 7655 5659

azad.ali@shearman.com

London

AATIF AHMAD

T: +44 20 7655 5120

aatif.ahmad@shearman.com

London

MAK JUDGE

T: +44 20 7655 5182

mak.judge@shearman.com

London / Singapore

OLIVER LINCH

T: +44 20 7655 5715

oliver.linch@shearman.com

London

THOMAS DONEGAN

T: +44 20 7655 5566

thomas.donegan@shearman.com

London

JOHN ADAMS

T: +44 20 7655 5740

john.adams@shearman.com

London

ANNA DOYLE

T: +44 20 7655 5978

anna.doyle@shearman.com

London

ELLIE TEO

T: +44 20 7655 5070

ellerina.teo@shearman.com

London

JAMES CAMPBELL

T: +44 20 7655 5570

james.campbell@shearman.com

London

BILL MURDIE

T: +44 20 7655 5149

bill.murdie@shearman.com

London

KOLJA STEHL

T: +49 69 9711 1623

kolja.stehl@shearman.com

Frankfurt / London

MARIA CHAN

T: +44 20 7655 5835

maria.chan@shearman.com

London

NATALIE CALDWELL

T: +44 20 7655 5722

natalie.caldwell@shearman.com

London

AMERICAS

DONALD N. LAMSON

T: +1 202 508 8130

donald.lamson@shearman.com

Washington, DC

BRADLEY K. SABEL

T: +1 212 848 8410

bsabel@shearman.com

New York

SYLVIA FAVRETTO

T: +1 202 508 8176

sylvia.favretto@shearman.com

Washington, DC

RUSSELL D. SACKS

T: +1 212 848 7585

rsacks@shearman.com

New York

REENA AGRAWAL SAHNI

T: +1 212 848 7324

reena.sahni@shearman.com

New York

CHRISTINA BROCH

T: +1 202 508 8028

christina.broch@shearman.com

Washington, DC

DONNA M. PARISI

T: +1 212 848 7367

dparisi@shearman.com

New York

JENNIFER D. MORTON

T: +1 212 848 5187

jennifer.morton@shearman.com

New York

ABU DHABI | BEIJING | BRUSSELS | FRANKFURT | HONG KONG | LONDON | MILAN | NEW YORK | PALO ALTO
PARIS | ROME | SAN FRANCISCO | SÃO PAULO | SHANGHAI | SINGAPORE | TOKYO | TORONTO | WASHINGTON, DC

shearman.com

This memorandum 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.

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069

Copyright © 2014 Shearman & Sterling LLP. Shearman & Sterling LLP is a limited liability partnership organized under the laws of the State of Delaware, with an affiliated limited liability partnership organized for the practice of law in the United Kingdom and Italy and an affiliated partnership organized for the practice of law in Hong Kong.