

Financial Regulatory Developments Focus



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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

ESMA Guidelines on Implementation of the Principles for Financial Market Infrastructures

On August 5, 2014, the European Securities and Markets Authority (“ESMA”) published Guidelines and Recommendations on the implementation of the Principles for Financial Market Infrastructures (the “PFMIs”) for CCPs. ESMA has published the Guidelines because a review is currently being undertaken of the EU’s implementation of the PFMIs, and ESMA is concerned that any assessment will not result in the correct outcome without the Guidelines. The European Market Infrastructure Regulation (“EMIR”) and its secondary legislation do not use the same operative language as that which is used in the PFMIs. The issue is of concern because of the competitive disadvantage for EU CCPs that could occur if it is deemed that the PFMIs have not been implemented properly in the EU. Under Basel III, if the regulatory requirements for CCPs are not implemented consistently with the PFMIs then banks might have to hold additional capital for exposures to such CCPs. This would not affect EU banks but would affect banks established outside of the EU. In addition, a EU CCP that wishes to gain access to markets outside of the EU would be disadvantaged if the requirement for such access was the proper implementation of the PFMIs in its host country. ESMA is of the view that the EMIR framework was established in accordance with the PFMIs but that the operative language difference may not make that apparent. The results would have unintended consequences on EU CCPs. The Guidelines direct national regulators to ensure that a CCP established in its country complies with the PFMIs.

The Guidelines are available at: <http://www.esma.europa.eu/news/ESMA-issues-guidelines-implementation-CPSS-IOSCO-Principles-market-infrastructures-respect-CCPs?t=326&o=home>.

IOSCO Launches Public Repository for Central Clearing Requirements for OTC Derivatives

On August 5, 2014, the International Organization of Securities Commissions announced the launch of an information repository for central clearing requirements for OTC derivatives. The repository provides the clearing requirements, and any applicable exemptions, on a product-by-product basis. The repository will be updated quarterly.

The announcement is available at:

http://www.iosco.org/library/index.cfm?section=information_repositories.

Bank Structure

Secondary Legislation on Excluded Activities and Prohibitions on Ring-fenced Banks

On August 5, 2014, the Financial Services and Markets Act 2000 (Excluded Activities and Prohibitions) Order 2014 was published. The Order sets out the activities that a ring-fenced bank may and may not carry out, including exceptions to the rule that a ring-fenced bank may not deal with investments as principal. The Order also restricts a ring-fenced bank from entering into any transactions which would enable it to use the services provided through an inter-bank payments system, restricts the exposures a ring-fenced bank may have to relevant financial institutions and provides that a ring-fenced bank may not have a subsidiary or branch outside of the EEA. The provisions setting out the defining terms in the Order come into effect on January 1, 2015. The remainder of the provisions will come into effect on January 1, 2019.

The Order is available at:

http://www.legislation.gov.uk/ukxi/2014/2080/pdfs/ukxi_20142080_en.pdf.

Recovery & Resolution

Federal Agencies Release Joint Statement on Second Round Resolution Plans of “First-Wave Filers”

On August 5, 2014, the Board of Governors of the Federal Reserve System (“Federal Reserve Board”) and the Federal Deposit Insurance Corporation (“FDIC”) provided feedback on the second round of resolution plans submitted by 11 large, global banking organizations. The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) requires that banking organizations with total consolidated assets of \$50 billion or more and non-bank financial companies designated by the Financial Stability Oversight Council for supervision by the Federal Reserve Board periodically submit resolution plans to the Federal Reserve Board and the FDIC. These plans, known as “living wills,” must describe the company’s strategy for rapid and orderly resolution in the event of material financial distress or failure of the company.

In their review, the Federal Reserve Board and the FDIC identified several common shortcomings of the resolution plans submitted by the first-wave filers. The common features include: (i) assumptions that the Federal Reserve Board and the FDIC regard as unrealistic or inadequately supported, such as assumptions about the likely behavior of customers, counterparties, investors, central clearing

facilities, and regulators; and (ii) the failure to make, and/or to identify, the kinds of changes in firm structure and practices that would be necessary to enhance the prospects for orderly resolution. The first-wave filers that submitted annual plans on or before July 1, 2014 must now demonstrate progress in addressing the shortcomings identified in the letters.

The full text of the joint Federal Reserve Board and FDIC statement is available at: <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140805-statement.htm>.

Bank Prudential Regulation & Regulatory Capital

EBA Publishes Final Draft RTS on Equity Exposures under IRB Approach

On August 5, 2014, the European Banking Authority (“EBA”) published its final draft regulatory technical standards (“RTS”) on the treatment of equity exposures under the internal ratings-based (“IRB”) approach under the Capital Requirements Regulation (“CRR”). The CRR allows national regulators to exempt certain equity exposures from IRB treatment held by firms as at December 31, 2007. The exemption is not new and was already provided for by the now repealed Banking Consolidation Directive. However, the CRR required the EBA to develop new draft RTS in order to specify further conditions under which national regulators would grant such an exemption. The final draft RTS provide that the exemption may be given if it was being applied on the last day of the application of the previous Capital Requirements Directive. The provision is temporary, ending on December 31, 2017. The RTS have now been submitted to the European Commission for adoption.

The RTS are available at:

<http://www.eba.europa.eu/documents/10180/775695/EBA+RTS+2014+13+%28Final+draft+RTS+on+the+IRB+equity+exemption%29.pdf/243ce507-7721-4500-a5c9-3d61dd246098>.

ECB Publishes Comprehensive Assessment Stress Test Manual

On August 8, 2014, the European Central Bank (“ECB”) published a Comprehensive Assessment Stress Test (“CAST”) Manual which details, within the ECB’s comprehensive assessment, (i) how the systematic quality assurance of the stress test outcomes produced by the banks will be carried out; and (ii) the process for combining the results of the stress test with the asset quality review. The ECB is conducting a comprehensive assessment of banks deemed to be significant under the Single Supervisory Mechanism (“SSM”) in advance of it assuming supervisory responsibilities for the prudential regulation of banks within the SSM in November this year.

The CAST manual is available at:

<http://www.ecb.europa.eu/pub/pdf/other/castmanual201408en.pdf>.

OCC Announces Final Rule on Assessment Rate Increase

On August 11, 2014, the Office of the Comptroller of the Currency (“OCC”) announced the adoption of a final rule that increases the OCC’s semiannual

assessment on national banks and federal savings associations (collectively, “banks”) with more than \$40 billion in assets. The final rule raises the marginal assessment rate on bank assets in excess of \$40 billion by 14.5%. For individual banks, the effective increase in the assessment rate varies with the total assets held by the banks, with increases ranging from between 0.32% and 14%. The increase in rates is effective for the assessment due on September 30, 2014.

The full text of the final rule is available at: <http://www.occ.gov/news-issuances/federal-register/79fr38769.pdf>.

Federal Agencies Announce Adoption of Final Rule Revising Advanced Approaches Risk-Based Capital Rules

On August 5, 2014, the OCC, the Federal Reserve Board and the FDIC announced the adoption of a final rule revising the advanced approaches risk-based capital rules by removing the requirement that only guarantees provided by certain counterparties are eligible for recognition as credit risk mitigants. Advanced-approaches banking organizations are generally those organizations with \$250 billion or more in total consolidated assets or \$10 billion or more in on-balance-sheet foreign exposure. The final rule expands the set of recognized guarantors by modifying the definition of “eligible guarantee” for purposes of the advanced approaches risk-based capital rules. The revised definition of “eligible guarantee” removes the requirement that an eligible guarantee be provided by an “eligible guarantor” for all exposures other than securitization exposures. This modified definition applies to all banking organizations subject to the advanced approaches rules.

The full text of the final rule is available at: <http://www.gpo.gov/fdsys/pkg/FR-2014-07-30/pdf/2014-17858.pdf>.

Basel Committee Extends Consultation Period for Review of Basel III Pillar 3 Disclosure Requirements

On August 6, 2014, the Basel Committee on Banking Supervision (the “Basel Committee”) announced that the consultation period on proposed revisions to the Basel III Pillar 3 disclosure requirements had been extended from September 26, 2014 to October 10, 2014. Pillar 3 aims to promote market discipline and a secure banking system, via regulatory disclosure requirements, and the new proposals are the result of concerns emerging about the lack of consistency on the form and granularity of information disclosed and on the interpretation of the requirements. The new proposals promote greater consistency for risk disclosure by banks and aim to assist market participants to assess more effectively a bank’s overall capital adequacy.

The consultation paper is available at: <http://www.bis.org/publ/bcbs286.pdf>.

Financial Services

EBA Consults on Criteria for the Exercise of Product Intervention Powers for Structured Deposits

On August 5, 2014, the EBA published a consultation on the criteria it will take into account when exercising its product intervention powers under the Markets in

Financial Instruments Regulation (“MiFIR”). Under MiFIR, the EBA is responsible for monitoring the markets for any structured products which are marketed, distributed or sold in the European Union. The EBA may temporarily prohibit or restrict (i) the marketing, distribution or sale of certain structured products within the EU; or (ii) a type of financial activity or practice. The European Commission has requested technical advice from the EBA on criteria and factors for the intervention powers for structured products so that the Commission may prepare legislation providing for the criteria to be taken into account by ESMA, the EBA and national regulators when determining if there is a significant investor protection concern or a threat to the orderly function of the markets in the EU. ESMA consulted earlier this year on technical advice regarding product intervention powers for financial instruments. The EBA and ESMA have worked together to prepare criteria that reflects the same principles while also allowing for the differences between structured products and financial instruments. The EBA consultation closes on October 5, 2014.

The consultation paper is available at:

<http://www.eba.europa.eu/documents/10180/774879/EBA-CP-2014-20+%28CP+on+MiFIR+technical+advice+for+structured+deposits%29.pdf>.

European Commission Reports on Functioning of European System of Financial Supervision

On August 8, 2014, the European Commission published its report to the European Parliament and the Council on the operation of the European Supervisory Authorities (“ESAs”) and the European System of Financial Supervision (“ESFS”) which came into effect in January 2011. The ESFS is made up of the ESAs, – ESMA, the EBA and the European Insurance and Occupational Pensions Authority – the EU national regulators and the European Systemic Risk Board. The Commission’s report states that the ESAs have performed well overall but also identifies areas for improvement in the short term as well as items for further consideration. The Commission recommends that the ESAs should, in the short term, focus on increasing supervisory convergence across the EU, prioritise investor protection (including by making full use of available powers), enhance internal governance and improve the transparency of the process for preparing draft technical standards or technical advice for the Commission. The Commission undertakes to ensure that: (i) the empowerments for technical standards in future legislative proposals have deadlines that match the entry into force of the primary legislation; and (ii) the timelines and scope of powers for technical standards are appropriate.

The report is available at:

http://ec.europa.eu/internal_market/finances/docs/committees/140808-esfs-review_en.pdf.

FCA Consults on Approach to Financial Promotions in Social Media

On August 6, 2014, the Financial Conduct Authority (“FCA”) launched a consultation setting out its proposed approach to financial promotions in social media. The FCA considers that firms need to think about how their financial promotions can be fair, clear and not misleading regardless of the means used and also to consider how image advertising can be used. In addition, the FCA is

seeking views on how firms, in using social media, can meet the specific financial promotion requirements such as: (i) ensuring that financial promotions for investment products are identified as such; (ii) ensuring that each communication, including a tweet or webpage, complies with the rules; and (iii) ensuring that the required risk warnings are included in promotions. The consultation is open until November 6, 2014.

The consultation paper is available at:

<http://www.fca.org.uk/static/documents/guidance-consultations/gc14-06.pdf>.

FCA Consults on the Establishment of Independent Governance Committees by Providers of Workplace Personal Pension Schemes

On August 6, 2014, the FCA published a consultation paper on proposed rules that would call for providers of workplace personal pension schemes to establish and maintain independent governance committees (“IGCs”). The key duties of the IGCs would be to act in the interest of relevant policyholders, assess whether the workplace personal pension schemes are high quality and offer value for money, escalate concerns to the FCA and alert the relevant scheme members and employers of any concerns, as well as producing an annual report of any of its findings. The consultation runs until October 10, 2014.

The consultation paper is available at:

<http://www.fca.org.uk/static/documents/consultation-papers/cp14-16.pdf>.

Consumer Protection

FCA to Restrict UK Firms from Distributing CoCos to Retail Investors

On August 5, 2014, the FCA announced a temporary restriction on authorized firms in the UK from distributing, promoting or intermediating transactions in contingent convertible instruments (known as "CoCos") to retail investors. The restriction will apply from October 1, 2014 to October 1, 2015. The FCA intends to consult in September 2014 on proposed permanent rules on CoCos. The restriction is the first time that the UK regulator is using its consumer protection powers which came into force last year when the FCA and Prudential Regulation Authority took over from the Financial Services Authority. The announcement also follows statements by the European Authorities expressing concerns about the potential risks of investing in CoCos.

The FCA announcement is available at: <http://www.fca.org.uk/news/restrictions-in-relation-to-the-retail-distribution-of-contingent-convertible-instruments>.

Funds

Guidelines on Reporting Obligations under AIFMD

On August 8, 2014, ESMA published the final translated Guidelines on reporting obligations under the Alternative Investment Fund Managers Directive. The Guidelines provide clarification on the information that alternative investment fund managers (“AIFMs”) must report to national regulators, the timing of such reporting and the procedures to be followed when AIFMs move from one

reporting obligation to another. The Guidelines, which apply to national regulators, will apply from October 8, 2014.

The Guidelines are available at: <http://www.esma.europa.eu/system/files/esma-2014-0004-00-00-en.pdf>.

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.

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