SHEARMAN & STERLING LLP

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Financial Regulatory Developments Focus

In this 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.

Click here if you wish to access our Financial Regulatory Developments website.

Our Governance & Securities Law Focus newsletter is available here.

You might like to view our Brexit Resource Center website, which is available here.

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Trump Administration Developments

Shearman & Sterling is providing practical insights on the implications of actions taken by the Trump Administration on an ongoing basis. To access our most recent publications on a wide variety of potential policy changes, please visit our website: The Trump Administration: What's Ahead.

President Trump Signs Executive Order on Financial Regulatory Reform

On February 3, 2017, President Trump signed an executive order setting forth "core principles" in the regulation of the US financial system and directing the Treasury Secretary to review and report back to the President within 120 days on the extent to which current government policies promote those principles and recommendations for actions to promote them. The core principles include the following: "prevent taxpayer-funded bailouts"; "foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry"; "enable American companies to be competitive with foreign firms in domestic and foreign markets"; "advance American interests in international financial regulatory negotiations and meetings"; and "restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework."

The Shearman & Sterling publication on the Trump executive order is available at: http://www.shearman.com/en/newsinsights/publications/2017/02/guide-to-trump-order-on-financial-reg-reform; and the text of the executive order is available at: https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-executive-order-core-principles-regulating-united-states.

President Trump Issues Presidential Memorandum Mandating Reconsideration of the Fiduciary Rule

On February 3, 2017, President Trump issued a Presidential Memorandum requiring the US Department of Labor to reconsider its proposed "fiduciary rule," which subjects many of the investment recommendations from financial advisors to retail retirement clients to ERISA's fiduciary standards and remedies. The Memorandum directs the Department of Labor to prepare an updated economic and legal analysis of the rule to determine whether, among other things, it may adversely affect the ability of Americans to gain access to retirement information and financial advice. Following the completion of the analysis, the Memorandum further directs the Department of Labor to consider whether it is appropriate to publish for notice and comment a proposal to revise or rescind the fiduciary rule. Although the Memorandum does not specifically require the Department of Labor to delay the April applicability date of the rule, some delay seems inevitable. Following the release of the memorandum, President Trump's acting Secretary of Labor, Ed Hugler, issued the following statement: "The Department of Labor will now consider its legal options to delay the applicability date as we comply with the President's Memorandum."

The Shearman & Sterling publication on the Presidential Memorandum is available at: http://www.shearman.com/en/newsinsights/publications/2017/02/reconsideration-of-dol-fiduciary-rule; the Shearman & Sterling overview of the fiduciary rule is available at: http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/04/The-US-Department-of-Labor-Final-Fiduciary-Rule-Incorporates-Concessions-to-Financial-Service-Industry-CGE-041416.pdf; and the text of the Presidential Memorandum is available at: https://www.whitehouse.gov/the-press-office/2017/02/03/presidential-memorandum-fiduciary-duty-rule.

Senate Finance Committee Approves Nomination of Steven Mnuchin for Treasury Secretary

On February 1, 2017, the US Senate Finance Committee approved the nomination of Steven Mnuchin to serve as Secretary of the Treasury, overruling an attempt by Senate Democrats to stall the nomination vote by boycotting the committee hearing by temporarily suspending committee rules that require at least one Democratic committee member to be present to conduct business. The full US Senate is expected to vote on his nomination the week of February 6th.

The results of the Senate Finance Committee vote are available at: https://www.finance.senate.gov/imo/media/doc/Results%20of%20Executive%20Session%20for%20Mnuchin%20and%20Price.pdf.

Republican Lawmaker Calls on Federal Reserve to Freeze Talks on International Regulatory Standards

On January 31, 2017, Representative Patrick McHenry (R-NC) issued a letter to Federal Reserve Chair Janet Yellen, calling on the Federal Reserve to cease negotiating "binding" international financial regulatory standards in such forums as the Financial Stability Board and the Basel Committee "until President Trump has had an opportunity to nominate and appoint officials that prioritize America's best interests." Rep. McHenry serves as Chief Deputy Whip in the US House of Representatives and as Vice Chairman of the Financial Services Committee of the US House of Representatives.

The text of Rep. McHenry's letter is available at: https://c.ymcdn.com/sites/iib.site-ym.com/resource/resmgr/weekly_bulletin/1-31-17McHenryLettertoYellen.pdf.

Trump Administration Memorandum and Executive Order on Regulatory Freeze

On January 20, 2017, Trump Administration Chief of Staff Reince Priebus issued a memorandum to the heads of executive departments and agencies instituting a temporary freeze of regulations that have not yet become effective in order to allow for review of such regulations by the President's appointees or designees. The memorandum, issued on the day of President Trump's inauguration, contains an exception for "emergency situations or other urgent circumstances relating to health, safety, financial or national security matters." The memorandum is somewhat unclear as to its applicability to independent regulatory agencies such as the US financial regulators including the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Consumer Financial Protection Bureau, the Commodity Futures Trading Commission and the Securities and Exchange Commission.

On January 30, 2017, President Trump issued an Executive Order which establishes a "regulatory cap" for Fiscal Year 2017 wherein, unless prohibited by law, any executive department or agency that publicly proposes a new regulation must identify two existing regulations for repeal. Accordingly, for Fiscal Year 2017, the Executive Order requires that the incremental cost of all new regulations, including repealed regulations, be no greater than zero.

The White House Memorandum for the Heads of Executive Departments and Agencies is available at: https://www.whitehouse.gov/the-press-office/2017/01/20/memorandum-heads-executive-departments-and-agencies; and the Executive Order on Reducing Regulation and Controlling Regulatory Costs is available at: https://www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling.

US House Financial Services Committee Chairman Jeb Hensarling Vows to Dismantle Dodd-Frank

On January 26, 2017, House Financial Services Committee Chairman Jeb Hensarling (R-TX) issued a statement in which he criticized the Dodd-Frank Wall Street Reform and Consumer Protection Act for institutionalizing big bank bailouts. He noted that Republicans on the Financial Services Committee are eager to work with President Trump and the new administration to replace the Dodd-Frank Act with his draft legislation, The Financial CHOICE Act. Additionally, Chairman Hensarling announced subcommittee assignments for Republican members on the House Financial Services Committee.

The statement is available at: http://financialservices.house.gov/news/documentsingle.aspx?DocumentID=401421; and the subcommittee assignments are available at: http://financialservices.house.gov/news/email/show.aspx?ID=EUJ4FRX3MTYU6O7ZLV2DLRFZOQ.

Bank Prudential Regulation & Regulatory Capital

US Board of Governors of the Federal Reserve System Releases CCAR Stress Test Scenarios for 2017

On February 3, 2017, the US Board of Governors of the Federal Reserve System released the scenarios to be used by banks and supervisors for the 2017 Comprehensive Capital Analysis and Review and stress test exercises (DFAST) mandated by the Dodd-Frank Act. The Federal Reserve Board concurrently issued instructions to firms participating in CCAR. For the 2017 cycle, a total of 13 of the largest and most complex bank holding companies will be subject to both the quantitative evaluation of their capital adequacy as well as a qualitative evaluation of their capital planning capabilities. The Federal Reserve Board had announced earlier, on January 30, 2017, that 21 firms with less complex operations will no longer be subject to the qualitative portion of CCAR.

Financial institutions are required to measure outcomes using three scenarios—severely adviser, adviser and baseline—in both the CCAR stress tests as well as the Dodd-Frank mandated stress tests. Each scenario includes 28 variables, including gross domestic product, unemployment rate, stock market prices, and interest rates, spanning domestic and international economic activity. Bank holding companies participating in CCAR are required to submit their capital plans and stress testing results to the Federal Reserve on or before April 5, 2017. The Federal Reserve will announce the results of its supervisory stress tests by June 30, 2017, with the exact date to be announced later.

The 2017 Stress Test Scenarios are available at: https://www.federalreserve.gov/newsevents/press/bcreg/bcreg20170203a5.pdf; and the CCAR summary instructions are available at: https://www.federalreserve.gov/newsevents/press/bcreg/bcreg20170203a4.pdf.

US Board of Governors of the Federal Reserve System Finalizes Amendments to Capital Plan and Stress Test Rules

On January 30, 2017, the US Federal Reserve Board adopted a final rule amending the capital plan and stress test rules effective for the 2017 cycle. The final rule removes large and noncomplex firms, specifically those with total consolidated assets of at least $50 billion but less than $250 billion, nonbank assets of less than $75 billion, and that are not deemed, pursuant to the Federal Reserve’s Regulation Q, to be US global systemically important banks, from the qualitative assessment of the Federal Reserve’s Comprehensive Capital Analysis and Review, thereby significantly reducing the burden on such firms. Accordingly, the qualitative review in CCAR is now focused on the 13 largest, most complex financial institutions.

The text of the final rule is available at: https://www.federalreserve.gov/newsevents/press/bcreg/bcreg20170130a1.pdf.

US Office of the Comptroller of the Currency Issues Examination Procedures on Third-Party Relationships: Risk Management Guidance

On January 24, 2017, the OCC issued examination procedures to supplement OCC Bulletin 2013-29 entitled "Third-Party Relationships: Risk Management Guidance," which was originally issued October 30, 2013. These procedures use the concepts and definitions in OCC Bulletin 2013-29 but are designed to help examiners: (i) tailor the examination of each bank commensurate with the level of risk and complexity of the bank's third-party relationships; (ii) assess the quantity of the bank's risk associated with its third-party relationships; (iii) assess the quality of the bank's risk management of third-party relationships involving critical activities; and (iv) determine whether there is an effective risk management process throughout the life cycle of the third-party relationship. The procedures include detailed questions examiners can ask when examining covered national banks and federal savings associations.

The examination procedures are available at: https://www.occ.gov/publications/publications-by-type/comptrollers-handbook/pub-third-party-exam-supplemental-procedures.pdf.

EU Standards on Benchmarking Portfolio Assessments Published

On February 3, 2017, a Commission Delegated Regulation in the form of Regulatory Technical Standards for benchmarking portfolio assessment standards and assessment-sharing procedures was published in the Official Journal of the European Union. The RTS supplement the Capital Requirements Directive. The CRD requires that national regulators monitor the range of risk-weighted exposure amounts or own funds requirements (except as regards operation risk) for the exposures or those relating to transactions in benchmark portfolios resulting from the internal approaches adopted by firms. Regulators are also required to assess, at least annually, the quality of the relevant approaches adopted by firms. The European Banking Authority is required to assist regulators in their assessments. The RTS set out the standards for the assessment by national regulators and procedures for sharing of those assessments with other relevant EU national regulators and with the EBA. The RTS enter into force on February 23, 2017 and will apply directly across the EU.

The RTS is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0180&from=EN.

European Banking Authority Final Guidelines on Application of Definition of Default Enter Into Force

On January 19, 2017, the EBA published translations of the final Guidelines specifying the application of the definition of default in relation to the Internal Ratings Based Approach and the Standardized Approach under the Capital Requirements Regulation. Publication of the translations triggers the date by which national regulators must inform the EBA as to whether they intend to comply with the Guidelines. That notification is due by March 20, 2017. The Guidelines will apply to national regulators and firms from January 1, 2021. However, national regulators have discretion to accelerate implementation of the Guidelines. The CRR sets out the definition of default of an obligor that is used for the purposes of the IRB and Standardized Approaches. The purpose of the Guidelines is to harmonize the definition of default across the EU framework so that EU banks apply regulatory requirements to their capital positions in a more consistent and comparable way, especially in the context of IRB models. The Guidelines expand on various aspects of the application of the definition of default including the "days past due" criterion for default identification, indications of unlikeliness to pay, specific aspects of the application of the definition of default for retail exposures, application of the default definition in a banking group, treatment of external data and criteria for a return to non-defaulted status. The EBA acknowledges that implementation of the Guidelines may take significant resources for certain firms, particularly those firms that apply the IRB Approach and where the default definition will significantly affect their existing approach.

The translations of the Guidelines are available at: http://www.eba.europa.eu/regulation-and-policy/credit-risk/guidelines-on-the-application-of-the-definition-of-default.

EU Final Legislation Specifying Conditions for Data Waiver Permissions Published

On January 14, 2017, a Commission Delegated Regulation, in the form of RTS specifying conditions for data waiver permissions, was published in the Official Journal of the European Union. The CRR outlines the requirements specific to own-loss given default ("own-LGD") for regulators when quantifying the risk parameters to be associated with rating grades or pools. The RTS lays down the mandatory conditions under which national regulators may grant firms permissions to use data covering a period of two years, rather than five years, for probability of default, own-LGD and own-conversion factor estimates as set out in the CRR. The RTS stipulates that exposures to central governments, central banks, banks and investment firms would be eligible for data waiver permissions, subject to certain additional requirements being met. First, exposures to corporates would be eligible for data waiver permissions where they are not structurally characterized by few or no observed defaults. Second, types of exposures which were not included in the bank or investment firm's portfolio at the time when the firm started to implement the IRB Approach should not be eligible for a data waiver permission.

The RTS stipulates both quantitative and qualitative conditions that must be satisfied before a national regulator may grant a data waiver permission, including that a firm provides well-documented evidence that certain qualitative conditions are satisfied for every type of exposure.

Regulators may only grant waiver permissions for the first five years after the date when a firm was first permitted to calculate its risk-weighted exposure amounts using the IRB Approach in accordance with the CRR. Data waivers granted by regulators before entry into force of the RTS will not be subject to the requirements of the RTS. The RTS will apply from February 3, 2017.

The RTS is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0072&from=EN&_sm_au_=iVVLpS18qJJN0T1Q.

Compensation

Latest EU Report on High Earners Published

On February 2, 2017, the EBA published a Report on high earners using data accumulated as at the end of 2015. The CRD, as amended, imposes compensation requirements on banks for staff who are considered to have a material impact on the bank's risk profile, and there is a cap on the ratio of fixed to variable compensation for identified staff—known as the bonus cap. The EBA is required to publish aggregated data on high earners who earn EUR 1 million or more per financial year. The EBA's report analyzes information for the year 2015 and compares it to 2014 data. The analysis shows, among other things, that the number of high earners awarded EUR 1 million or more in annual remuneration has increased by 33%, largely as a result of changes in the exchange rate between the euro and pound sterling. The number of identified staff was largely unchanged between 2014 and 2015.

In previous years the EBA has published this data at the same time as the benchmarking of remuneration trends. Going forward, the benchmarking information will be published only biannually. The data on high earners will continue to be published annually.

The Report is available at: http://www.eba.europa.eu/documents/10180/1720738/EBA+Final+Report+on+High+Earners+2015.pdf.

Consumer Protection

US Consumer Financial Protection Bureau Issues Compliance Guide on Prepaid Rule and Remittance Transfers

On January 31, 2017, the CFPB provided summary and highlights information regarding the implementation of the Prepaid Rule, which creates tailored provisions for prepaid accounts governing disclosures, limited liability and error resolutions, and periodic statements. The CFPB concurrently issued a compliance guide on remittance transfers.

The CFPB compliance guide on the Prepaid Rule is available at: http://www.consumerfinance.gov/policy-compliance/guidance/implementation-guidance/prepaid-rule/; the CFPB compliance guide on remittance transfers is available at: https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201701_cfpb_Intl_Money_Transfer_Small_Entity_Compliance_Guide.pdf?_sm_au_=iVVW3Mrrp3rDQ2QP.

Bank Structural Reform

UK Prudential Regulation Authority Finalizes Reporting and Prudential Requirements for Ring-Fenced Banks

On February 1, 2017, the UK Prudential Regulation Authority published a Policy Statement, final rules and updates on several Supervisory Statements on the reporting, prudential and recovery and resolution requirements to implement the ring-fencing requirements for banks. The PRA's policy and final rules are relevant to all firms that are required to ring-fence their core banking activities before the implementation date of January 1, 2019. These firms are, broadly speaking, those with at least £25 billion of "core" deposits (defined as deposits from individuals and small businesses) and those that expect to exceed the threshold by January 1, 2019. UK banking groups that have more than £25 billion of core deposits will need to ring-fence the entity or entities that accept core deposits—called ring-fenced bodies—by transferring other business lines to different legal vehicles or undertaking other business separations.

The PRA consulted on the changes in the last half of 2016. Having assessed the feedback received, the PRA has not made significant changes to its original proposals. However, the PRA has provided clarification on certain issues, which are mostly set out in the updated Supervisory Statements. The final rules and policy will, among other things, require an RFB to meet Pillar 3 disclosure requirements on a sub-consolidated basis. The PRA clarifies that the reporting requirements will mean that where a significant subsidiary satisfies the Pillar 3 disclosure requirements on a sub-consolidated basis due to being part of an RFB sub-group, the subsidiary will not have to meet the requirements on an individual basis as well.

In addition, RFBs will need to report on their use of the exceptions available which will allow them to undertake certain activities that are otherwise excluded and prohibited under the ring-fencing laws and will need to submit data to show how they have complied with the ring-fencing rules (to the extent that that data is not already reported under other rules).

Furthermore, a bank will be required, if not in a group, to notify the PRA within 30 days of it becoming aware, or having information which reasonably suggests, that its total core deposits have increased to over £25 billion or have decreased to less than or equal to £25 billion. The same will apply if the bank is in a group where the sum of core deposits of all relevant group members have increased to over £25 billion or has decreased to less than or equal to £25 billion.

A group that includes an RFB will need to include recovery options for the RFB sub-group in its recovery plan. The PRA clarifies that the indicator framework, design of scenarios and governance arrangements in the group recovery plan should take into account recovery planning for the RFB as well as the group as a whole.

The Policy Statement is available at: http://www.bankofengland.co.uk/pra/Documents/publications/ps/2017/ps317.pdf; the final rules are available at: http://www.bankofengland.co.uk/pra/Documents/publications/ps/2017/ps317app1.pdf; the Supervisory Statement on Ring-fenced Bodies is available at: http://www.bankofengland.co.uk/pra/Documents

/publications/ss/2017/ss816update.pdf; the Statement of Policy on the PRA's methodologies for setting Pillar 2 capital is available at: http://www.bankofengland.co.uk/pra/Documents/publications/sop/2017/p2methodologiesupdate.pdf; the Supervisory Statement on Guidelines on completing regulatory reports is available at: http://www.bankofengland.co.uk/pra/Documents/publications/ss/2017/ss3415update.pdf; the Supervisory Statement on the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP) is available at: http://www.bankofengland.co.uk/pra/Documents/publications/ss/2017/ss3115update.pdf; and the Supervisory Statement on Pillar 2 reporting, including instructions for completing data items FSA071 to FSA082 is available at: http://www.bankofengland.co.uk/pra/Documents/publications/ps/2017/ps317app6.pdf.

Derivatives

Proposed EU Guidelines on Transfer of Data Between Trade Repositories

On January 31, 2017, the European Securities and Markets Authority launched a consultation on proposed Guidelines on the transfer of data between trade repositories. The European Market Infrastructure Regulation requires counterparties and central counterparties to report trades to a trade repository while ensuring that details of their derivatives contracts are reported without duplication. EMIR also requires trade repositories to maintain reported information for a period of 10 years following the termination of the derivative.

Where a trade repository's registration with ESMA is withdrawn, the trade repository is required to ensure the transfer of data to other trade repositories and the redirection of reporting flows to other trade repositories. Data may also be transferred between trade repositories at the request of a counterparty to a derivative or the entity reporting on its behalf. The proposed Guidelines set out the related requirements for the transfer of data between trade repositories, including the requirements for trade repositories to develop a migration plan, fees and communications with the relevant national authorities.

The proposed Guidelines would apply to counterparties to derivatives contracts, CCPs and trade repositories. The consultation closes on March 31, 2017. ESMA intends to publish a report and the final Guidelines by the end of Q2 or beginning of Q3 2017.

The consultation paper is available at: https://www.esma.europa.eu/press-news/esma-news/esma-consults-future-guidelines-portability-between-trade-repositories.

European Securities and Markets Authority Opines on Exemption for Spanish-Based Pension Schemes From the Clearing Obligation

On January 25, 2017, ESMA published an Opinion on Spanish-based pension schemes that are to be exempted from the clearing obligation under EMIR. The Opinion was requested by Comisión Nacional del Mercado de Valores (the Spanish Regulator responsible for supervising and inspecting Spanish Stock Markets). Transitional exemptions from the clearing obligation under EMIR can be granted to pension scheme arrangements that meet certain criteria, essentially, when over-the-counter derivatives contracts are entered into and are used for hedging purposes. To obtain an exemption, requests must be made by the pension scheme to a national regulator and the national regulator must then seek an Opinion from ESMA before making a final exemption decision. ESMA must consult the European Insurance and Occupational Pensions Authority before adopting an Opinion.

ESMA has adopted the Opinion on the basis that the Spanish Regulator is of the view that Personal Pension Funds would encounter difficulties in meeting variation margin requirements for centrally-cleared transactions due to limited holdings of cash within the entity (e.g. lower investment returns or transaction costs) and the risk of inefficiencies as a result of converting assets into cash.

ESMA's Opinion is available at: https://www.esma.europa.eu/press-news/esma-news/esma-issues-opinion-spanish-pension-schemes-be-excempt-central-clearing-under.

EU Legislation Amending Technical Standards on the Format and Frequency of Trade Reporting Published

On January 21, 2017, a Commission Implementing Regulation amending Implementing Technical Standards on the format and frequency of trade reports submitted to trade repositories was published in the Official Journal of the European Union. The original ITS, published in the Official Journal on December 21, 2012, supplements the reporting requirements in EMIR. ESMA provided a final draft amending ITS to the European Commission in November 2015. ESMA considered that the original standards needed to be updated to incorporate the feedback and Q&As during implementation of the reporting requirement under EMIR since 2013. The text of the final amending ITS differs from the text of ESMA's final draft ITS; however, the changes are minor. The revisions to the original ITS include, among other things: (i) specific rules to assist in the determination of who are the buyer and seller to various types of swap derivative contract for reporting purposes; (ii) rules for reporting collateralization for a given derivative contract or portfolio; (iii) criteria for the generation of unique trade identifiers where two counterparties cannot agree on responsibility for generating a unique identifier within the reporting timeline; (iv) extension of the period for reporting terminated trades from three to five years from the commencement date of reporting; and (v) updated standards and formats to be used in trade data reports. The amending ITS will enter into force on February 10, 2017. The revised reporting obligations will apply from November 1, 2017, which should allow counterparties enough time to prepare for the incoming changes.

The amending ITS is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R0105&from=EN; and the original ITS is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R1247&from=EN.

EU Legislation Amending Technical Standards on Derivatives Trade Reporting Published

On January 21, 2017, a Commission Delegated Regulation amending RTS on the minimum details of data to be reported to trade repositories was published in the Official Journal of the European Union. The original RTS were published in the Official Journal on February 23, 2013 and supplement the reporting requirements imposed by EMIR. ESMA provided a final draft amending RTS to the European Commission in November 2015. ESMA considered that the current standards need to be updated to incorporate the feedback and Q&As during implementation of the reporting requirement under EMIR since 2013. The text of the final amending RTS differs from the text of ESMA's final draft RTS; however, the changes are minor. The revisions to the original RTS include: (i) allowing the use of multiple reports for the reporting of complex derivatives, provided that counterparties agree the number of reports to be submitted; (ii) adding a new definition for the notional amount of a derivative; (iii) clarifying the reporting requirements for cleared trades; and (iv) requiring that all collateral that has been posted and received is reported, including amending the fields for reporting of collateral to, among other things, split the value field into initial margin posted and variation margin posted. The amending RTS will enter into force on February 10, 2017. The revised reporting obligations will apply from November 1, 2017, which should allow counterparties enough time to prepare for the incoming changes.

The amending RTS is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R0104.

European Commission Publishes Correcting Amendment to Regulatory Technical Standards on Margin Requirements for Uncleared Transactions

On January 20, 2017, the European Commission published a draft Commission Delegated Regulation amending the RTS on margin requirements for uncleared derivatives. The amending RTS relate to the phase-in of the variation margin requirements for intra-group transactions and supplement EMIR. The original RTS on risk mitigation techniques for uncleared OTC derivatives was published in the Official Journal of the European Union on December 15, 2016. The correction is due to a technical error in the adoption process which resulted in the two paragraphs on the phase-in of the variation margin requirements to intra-group transactions being omitted.

EMIR requires counterparties to uncleared OTC derivative transactions to implement risk mitigation techniques to reduce counterparty credit risk. The original RTS prescribe how margin is to be posted and collected and the methodologies by which the minimum amount of initial margin and variation margin should be calculated, as well as specifying a list of securities eligible as collateral for the exchange of margins, such as sovereign securities, covered bonds, specific securitizations, corporate bonds, gold and equities.

The amending RTS update the original RTS by inserting two new paragraphs specifying the phase-in schedule for variation margin requirements for intra-group transactions. Where an intra-group transaction takes place between a Member State entity and a third country entity, the exchange of variation margin is not required until three years after entry into force of the amended RTS but only where there is no equivalence decision for that third country. Where there is an equivalence decision the variation margin requirements will apply either four months after the entry into force of the equivalence decision, or according to the timeline outlined in the original RTS, whichever is later.

The amending RTS will enter into force on the day of its publication in the Official Journal of the European Union and will apply retroactively from January 4, 2017 so as to coincide with the dates of the original RTS.

The amending RTS is available at: http://ec.europa.eu/transparency/regdoc/rep/3/2017/EN/C-2017-149-F1-EN-MAIN-PART-1.PDF?_sm_au_=iVVLpS18qJJN0T1Q; and the original RTS is available at http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1485801630726&uri=CELEX:32016R2251.

European Authorities Publish Report on Joint Functioning of EU Capital Requirements and European Market Infrastructure Regulation

On January 18, 2017, the EBA and ESMA published a Report on the joint functioning of the CRR and EMIR. The focus of the Report is on capital requirements for CCPs that also hold a banking license, leverage and liquidity for CCPs, large exposures, difference in application of the margin period of risk and the requirements on a client’s exposures to clearing members.

The EBA and ESMA note that although the EMIR and CRR requirements may appear to be redundant for CCPs holding a bank license, because some aspects of the EMIR requirements are more stringent, they are in fact based on different definitions of capital and take into account different types of risks. Therefore, CCPs holding a banking license are subject to both capital requirements as a matter of principle, with some exemptions when they are properly justified. There are currently 17 authorized CCPs, of which three hold a banking license—Eurex Clearing AG, LCH Clearnet SA and European Commodity Clearing AG.

The EBA and ESMA conclude that the application of CRR capital requirements to CCPs holding a bank license can lead to duplicative requirements for CCPs. The EBA and ESMA recommend that the treatment of CRR capital requirements for exposures already covered by EMIR financial resource requirements should be clarified by exempting those CCPs from (i) certain requirements on credit risk, counterparty credit risk and market risk exposures; and (ii) the requirements on exposures to CCPs where an interoperability arrangement is established.

The EBA and ESMA consider that the application of the Leverage Ratio is problematic as it would constrain activity, but have taken the view that international consistency is a key concern and that it is important to wait until conclusions have been reached at the international table before the EU regime is amended. This is despite the EBA stating in separate reports that an exemption would be appropriate for CCPs in relation to NSFR and LR.

The EBA and ESMA note that the large exposure requirement does not currently pose any limitation to a CCP's activity (due to the exemption provided for clearing and settlement) and given that the framework is currently under review by the Commission, the issue is not further developed in the Report.

The Report also compares the application of the MPoR under the CRR with that of the liquidation periods (which are conceptually similar to the MPoR) in EMIR. The EBA and ESMA do not suggest any changes to the MPoR in the CRR concerning the treatment of a clearing member's exposure to clients.

The Report finally considers clients' exposures to clearing members under both the CRR and EMIR framework. The CRR requires that four conditions must be met for the two percent risk weight to apply: segregation, portability, independent legal opinion and qualified CCP. The EBA and ESMA have recommended that the Commission clarify the wording in the CRR regarding the segregation, portability and legal opinion requirements. The proposals to amend the CRR published by the Commission in November 2016 include revisions to the treatment of client exposures. In particular, the draft legislation replaces the requirement for a legal opinion with a requirement for the client to carry out a sufficiently thorough legal review. However, there is no guidance in the draft legislation as to what this will actually mean in practice and although a legal opinion may no longer be needed, the underlying analysis to be conducted remains broadly similar. The EBA and ESMA do not refer to the Commission's proposed amendments on CCP exposures.

The Report is available at: http://www.eba.europa.eu/documents/10180/1720738/Report+on+the+interaction+with+EMIR+%28ESAS-2017-82+%29.pdf; and the Commission's proposals to revise CRD IV are available at: http://finreg.shearman.com/european-commission-proposes-draft-quotcrd5quot-a.

European Securities and Markets Authority Requests a Review of Its Sanctioning Powers Under the European Market Infrastructure Regulation

On January 30, 2017, ESMA published an open letter to the European Commission asking it to consider several issues relating to its supervisory and sanctioning powers under EMIR and emphasizing similar aspects relating to Credit Rating Agencies. The letter follows the Commission's Report, published on November 23, 2016, assessing the issues arising from the implementation of the requirements of EMIR in which the Commission proposed a legislative review of EMIR in 2017. ESMA submitted four reports to the Commission in 2015 on the functioning of EMIR which included recommendations on how EMIR could be enhanced. The letter highlights the areas in those reports that ESMA considers the Commission should consider as part of the EMIR review this year.

ESMA recommended in 2015 that its sanctioning powers and the level of trade repository fines should be increased by 10 times to make them more comparable with those in place for Credit Ratings Agencies. ESMA requests the inclusion of the following enhanced supervisory tools: (i) the possibility for ESMA to oppose material changes to the conditions of registration; (ii) an obligation for TRs to submit periodic information to ESMA; and (iii) sanctions for the breaches of the obligation to notify periodic information and material changes to the conditions of registration. ESMA also identifies what it views as some essential additional requirements for TRs relating to data quality and data access which should be included as part of the reporting requirement, such as an alignment with the Securities Financing Transactions and Re-use Regulation logic of reporting the trade by both counterparties, but with certain exemptions (for instance, non-financial counterparties).

ESMA also highlights other recommendations made in its four reports, such as amendments to the clearing obligation framework and a review of the language of Articles that set the default management and protections, redefining and recalibrating the categories of large and small NFCs and their related obligations, improving the transparency and predictability of margin requirements, and revising the third country CCP recognition framework to put in place a timely and risk based process.

ESMA submitted to the Commission two sets of technical advice and a report on the regulation of CRAs on October 2, 2015. The papers provide an overview of the industry and the impact of specific provision of the CRA Regulation. The Commission published a report on October 19, 2016, which assessed the state of the credit rating market including issues of competition and governance. Further to the CRA reports, ESMA highlights amendments equivalent to those proposed for EMIR, including an extension of the types of enforcement decisions that can be adopted by ESMA.

The letter is available at: https://www.esma.europa.eu/press-news/esma-news/esma-letter-emir-review-and-sanctioning-powers-european-commission.

Enforcement

UK Regulators Finalize Changes to Enhance Their Enforcement Decision-Making Processes

On February 1, 2017, the Financial Conduct Authority and PRA published a joint Policy Statement on changes to their enforcement decision-making processes. The changes are in response to the recommendations set out in HM Treasury's Review of enforcement decision-making at the financial services regulators (known as the Enforcement Review), published in December 2014, and the report by Andrew Green QC in the enforcement actions following the failure of HBOS (known as the Green Report), published in November 2015. The Enforcement Review and the Green Report made three overlapping recommendations about the regulators' decision-making processes covering pre-referral decision-making, communication and cooperation between and within the regulators and informing the subject of an investigation about the matters under investigation.

The Policy Statement follows the consultation conducted by the FCA and PRA in 2016 and sets out the regulators' policy on joint investigations and cooperation. It also sets out the FCA's policy on referral decision-making, settlement and contested-decision making. The revisions to the FCA's rules took effect on January 31, 2017 except for those on the introduction of partly contested cases and the abolition of stage 2 and 3 discounts to penalty in settlement, which will apply from March 1, 2017. The PRA will issue a policy statement later this year on the establishment of the Enforcement Decision Making Committee and a short guide to the PRA's enforcement processes.

The joint Policy Statement is available at: https://www.fca.org.uk/publication/policy/ps17-01.pdf; the Enforcement Review is available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/389063/enforcement_review_response_final.pdf; and the Green Report is available at: http://www.bankofengland.co.uk/pra/Documents/publications/reports/agreenreport.pdf.

HSBC to Provide Voluntary Redress for Historical Debt Collection Practices

On January 20, 2017, the FCA announced that HSBC Bank Plc has voluntarily agreed to set up a redress scheme of approximately £4 million for customers who suffered detriment by paying unreasonable debt collection charges imposed by HFC Bank Ltd and John Lewis Financial Services Ltd. HSBC now owns both HFC and JLFS. Customers of HFC and JLFS who, between 2003 and 2009, fell into arrears were referred to the firms' nominated solicitors. The solicitors added a "debt collection charge" of 16.4% of the customer's balance to each customer's account. The charge was identified by the Office of Fair Trading in 2010 as unreasonable as it did not reflect the actual costs of collecting the debt and the OFT in November 2010 formally ordered HFC to stop adding the collection charge until it varied or introduced new terms into its agreements with customers to reflect the charge. JLFS was not within the scope of the

OFT's review. In practice, JLFS and OFT had stopped adding a debt collection charge in November 2009, and in 2010 reversed the charge from all live accounts.

In December 2015, the FCA announced that it would reconsider its decision not to investigate allegations about the conduct of HFC following a complaint to the Complaints Commissioner. Following that announcement, the FCA conducted a review of complaints against HFC and JLFS and established that approximately 6,700 customers paid debt collection charges prior to 2010 either in full, or in part, and were potentially entitled to redress. HSBC has agreed to repay to such customers the excess amounts above the actual and necessary debt collection costs, in accordance to a methodology that has been agreed by the FCA.

HSBC has also committed to repay the amount of the incorrectly overcharged interest to certain other customers. For each group of customers which are due redress, HSBC will also pay 8% interest per annum. HSBC will proactively contact all affected customers.

The announcement is available at: https://www.fca.org.uk/news/press-releases/hsbc-voluntarily-agrees-provide-approximately-4m-redress-historical-debt.

Financial Crime

State Financial Regulators Release Anti-Money Laundering Compliance Tool

On January 31, 2017, state financial regulators released a new, voluntary tool designed to help banks and non-depository financial institutions better manage Bank Secrecy Act/Anti-Money Laundering risk. The BSA/AML Self-Assessment Tool was developed by the Conference of State Bank Supervisors and state regulators and aims to help institutions better identify, monitor and communicate BSA/AML risk. In this way, the tool is intended to reduce uncertainty surrounding BSA/AML compliance and encourage greater transparency within the financial sector.

The CSBS press release regarding the BSA/AML Self-Assessment Tool is available at: https://www.csbs.org/news/press-releases/pr2017/Pages/013117.aspx.

Final Guidelines on Disclosure of Information on Commodity Derivatives and Spot Markets Take Effect

On January 17, 2017, ESMA published translations of the final Guidelines on information expected or required to be disclosed on commodity derivatives markets or related spot markets under the Market Abuse Regulation in the official languages of the EU. MAR replaced the current Market Abuse Directive and its implementing legislation from July 3, 2016. The publication of the translations triggers the application of the Guidelines from March 17, 2017. The Guidelines are relevant to national regulators and to commodity derivatives market participants such as investors, financial intermediaries, operators of trading venues and persons professionally arranging and executing transactions in commodity derivatives. National regulators have until March 17, 2016 to advise ESMA whether or not they intend to comply with the final Guidelines.

One of the changes that MAR introduced is the expansion of the definition of inside information relating to commodity derivatives to cover price sensitive information relevant to the related spot commodity contracts as well as the derivative. This means that transactions in commodity derivatives based on inside information relating to underlying spot transactions will be expressly prohibited. In addition, the market manipulation prohibitions will include transactions in derivatives markets that manipulate the related spot commodity transaction and transactions in spot commodity markets that manipulate the related derivative. Under MAR, market participants must disclose inside information to the public, with delayed or selective disclosure allowed in only limited circumstances. MAR requires ESMA to issue guidelines to establish a non-exhaustive list of information which is reasonably expected or is required to be disclosed in accordance with EU or national law requirements, on the relevant commodity derivatives markets or spot markets. Inside information for commodity derivatives includes information that is of a precise nature which has not yet been made

public that relates, either directly or indirectly, to one or more derivatives or directly to the related spot commodity contract and which, if made public, would likely have a significant effect on the prices of such derivatives or contracts. The final Guidelines stipulate that for information to be "reasonably expected to be disclosed" it should be: (i) widely accessible in a non-discriminatory way after disclosure; (ii) contained in an official statement and not part of a private or personal opinion or analysis; and (iii) not a rumor nor a speculative statement.

Examples of information relating directly to commodity derivatives includes information required to be published by trading venues in accordance with the revised Markets in Financial Instruments Directive about the aggregate position held by different categories of persons for the different commodity derivatives traded on their venue. To the extent that the commodity derivatives are standardized, the final Guidelines state that market participants would reasonably expect to receive infrequent information about the circumstances affecting the fundamental characteristics of the commodity derivative or the contract on which such commodity derivative is based.

The translations of the Guidelines are available at: https://www.esma.europa.eu/document/mar-guidelines-commodity-derivatives.

UK Regulator Fines Deutsche Bank for AML Control Failings Related to Mirror Trading

On January 31, 2017, the FCA published a final notice issued to Deutsche Bank AG and fined the bank £163 million for failing to maintain an adequate AML control framework between January 1, 2012 and December 31, 2015. Deutsche Bank notified the FCA in early 2015 of concerns about its AML control framework after the bank had begun an investigation into suspicious securities trading, known as "mirror trading." The orders for both sides of the mirror trades were received and executed by Deutsche Bank's Moscow office. The Moscow office executed the trades on behalf of Deutsche Bank via remote booking by directly booking trades to Deutsche Bank's trading books in the UK. The FCA's investigation revealed that the mirror trading was able to be executed by Deutsche Bank's Moscow office because of the widespread deficiencies in the bank's AML control framework, in particular, the bank performed inadequate customer due diligence, failed to ensure that its front office took responsibility for it's Know Your Customer obligations, used flawed customer and country risk rating methodologies, had deficient AML policies and procedures, had an inadequate AML IT infrastructure, lacked automated AML systems for detecting suspicious trades and failed to provide adequate oversight of trades booked in the UK by traders in non-UK jurisdictions.

The FCA noted that the scale, volume and the way the trades were conducted were "highly suggestive" of financial crime. Deutsche Bank was used by unidentified customers to transfer approximately $10 billion, of unknown origin, from Russia to offshore bank accounts. As a result, the bank had put itself and the UK financial system at risk. However, the regulator considered that the failings in the AML framework had not been committed deliberately or recklessly and there was no evidence that any of the senior management or employees of Deutsche Bank in London had been aware of or involved in the suspicious trading.

The fine is made up of a disgorgement of around £9 million and a penalty of £154 million. Deutsche Bank has undertaken to cooperate with any other regulator or enforcement agency that is investigating or commences an investigation into the matter.

The final notice is available at: https://www.fca.org.uk/publication/final-notices/deutsche-bank-2017.pdf; and the FCA announcement is available at: https://www.fca.org.uk/news/press-releases/fca-fines-deutsche-bank-163-million-anti-money-laundering-controls-failure.

Financial Market Infrastructure

European Securities and Markets Authority Announces Details of 2017 EU-Wide CCP Stress Test

On February 1, 2017, ESMA announced details of the 2017 EU-wide CCP stress test exercise. EMIR requires ESMA to conduct the exercise at least once per year to assess the resilience and safety of the EU's CCPs from a systemic risk viewpoint. The exercise covers 17 EU CCPs and includes all products currently cleared by the CCPs. ESMA may issue recommendations to address any issues that are highlighted by the exercise. The results of the exercise are expected to be published in Q4 2017.

The ESMA's announcement and framework methodology is available at: https://www.esma.europa.eu/press-news/esma-news/esma-announces-details-2017-ccp-stress-test.

Financial Stability Board Consults on Guidance on CCP Resolution and Resolution Planning

On February 1, 2017, the FSB published proposed Guidance on CCP resolution and resolution planning. The aim of the proposed Guidance is to assist national authorities and FSB member jurisdictions in implementing effective resolution regimes, credit resolution strategies and plans for CCPs that are consistent with the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions and the financial market infrastructure guidance annexed to the Key Attributes. The FSB published a Discussion Note on August 16, 2016 which sought feedback on aspects of CCP resolution that are key to the design of effective resolution strategies. The FSB's proposed Guidance is based on responses to that Discussion Note as well as further consultations with FSB member authorities. The FSB is seeking feedback on, among other things, the powers that resolution authorities should have to maintain the continuity of critical CCP functions, return the CCP to a matched book and address default and non-default losses, the treatment of equity of existing CCP owners in a CCP resolution and cross-border enforcement of resolution actions. Among others, it is proposed that resolution authorities should have power to write down initial margin as well as variation margin. The assessment for the "no creditor worse off" test is proposed to be based upon what would happen following exercise of all CCP post-default powers. Responses to the consultation are requested by March 13, 2017.

The consultation paper is available at: http://www.fsb.org/wp-content/uploads/Guidance-on-Central-Counterparty-Resolution-and-Resolution-Planning.pdf; the FSB's summary of responses to the discussion paper is available at: http://www.fsb.org/wp-content/uploads/Overview-of-Responses-to-the-Discussion-Note.pdf; and the discussion paper is available at: http://www.fsb.org/wp-content/uploads/Essential-Aspects-of-CCP-Resolution-Planning.pdf.

Financial Services

UK Legislation Implementing the Bank of England and Financial Services Act Comes Into Force

On January 20, 2017, the Bank of England and Financial Services Act 2016 (Commencement No 4 and Saving Provision) Regulations 2017 came into force. The Regulations set March 1, 2017 as the date on which certain provisions of the Bank of England and Financial Services Act 2016 will apply, including those provisions which will transfer the functions of the PRA to the Bank of England. Those functions will be exercised through the Prudential Regulation Committee.

The Regulations are available to view at: http://www.legislation.gov.uk/uksi/2017/43/pdfs/uksi_20170043_en.pdf.

European Commission Holds Public Consultation on the Capital Markets Union Mid-Term Review

On January 20, 2017, the European Commission launched a public consultation on the Capital Markets Union program and how it could be updated and completed, building on the initiatives that the Commission has presented so far, as part of the mid-term review. The mid-term review of the CMU action plan is scheduled for June 2017. The CMU Action Plan was published in September 2015 and set out priorities for putting in place the building blocks of a CMU by 2019. The Commission also published a Communication in September 2016 reaffirming its commitment to the CMU, calling

for an acceleration of reform and outlining steps to increase the rate of completion. The Commission has completed 15 of the initiatives set out in the Action Plan (approximately half), including making progress on core legislative initiatives such as the proposed Prospectus Regulation and Securitization Regulation. Several more initiatives are expected to be launched in the coming months, including a proposal for simple, efficient and competitive personal pensions, promotion of the FinTech sector with an appropriate regulatory environment and sustainable finance.

As part of the mid-term review of the Action Plan, the Commission will take stock of the progress on its implementation, update actions in light of the work undertaken to date and the evolving market conditions as well as introduce new measures to complement the Action Plan.

The Commission seeks feedback on how the CMU can be updated and completed. Responses to the consultation are due by March 17, 2017. The Commission aims to present the outcome of the consultation during the CMU public hearing on April 11, 2017.

The consultation paper is available at: https://ec.europa.eu/info/finance-consultations-2017-cmu-mid-term-review_en.

UK Regulator Proposals to Amend Client Money Distribution Rules

On January 23, 2017, the FCA published a consultation paper on proposed changes to the client money distribution rules in the Client Assets Sourcebook of the FCA Handbook - CASS 7A - as a result of the special administration regime review. The client money rules govern how client assets are to be distributed by an insolvency practitioner managing a failed investment firm. The proposals focus on rule changes following the introduction in early January 2017 by the Government of draft regulations to improve the regime in line with the Bloxham Report's recommendations, i.e. The Investment Bank (Amendment of Definition) and Special Administration (Amendment) Regulations 2017, the Amending SAR Regulations.

The consultation follows the FCA's discussion paper published in September 2016 which set out its proposed approach to implementing certain of the recommendations of the Bloxham Report, which recommendations aim to minimize the market impact of a failed firm's entry into special administration. The FCA consultation paper sets out a host of technical changes mostly relating to the treatment of client money or client assets for firms post-administration, but also include some other amendments of compliance relevance. The consultation seeks input on the proposed changes to the CASS rules as a result of the Amending SAR Regulations, while also recognizing that not all firms that are subject to the CASS rules are subject to the SAR Regulations. There are also new proposals implementing changes to CASS in order to better fit with the indirect clearing requirements of EMIR and the incoming RTS under the Markets in Financial Instruments Regulation, which have been adopted by the European Commission but have not yet come into force. The FCA's proposals are relevant to all regulated firms that hold custody assets and/or client money for investment business, their clients, their banks and custodians and CCPs and exchanges.

Responses to the FCA's proposals relating to the indirect clearing requirements are due by February 23, 2017. Responses to all of the other proposals are due by April 24, 2017. The FCA aims to publish a policy statement containing final rules in summer 2017.

The consultation paper is available at: https://www.fca.org.uk/publication/consultation/cp17-02.pdf; and the Bloxham Report is available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/190983/peter_bloxham_review_of_investment_bank_sar2011_.pdf.

Draft UK Legislation to Amend the Special Administration Regime for Investment Firms Published

On January 10, 2017, the UK Government published draft legislation to amend the Special Administration Regulations, i.e. The Investment Bank (Amendment of Definition) and Special Administration (Amendment) Regulations 2017, the Amending SAR Regulations. The purpose of the draft legislation is to improve the return of client money when an

investment firm fails. The changes are in line with the Bloxham Report's recommendations which aim to minimize the market impact of a failed firm's entry into special administration. The draft Amending SAR Regulations amend the scope of the SAR Regulations to include firms that manage an alternative investment fund or Undertakings for the Collective Investment of Transferable Securities or who act as a trustee or depositary for an AIF or UCITS. The Amending SAR Regulations will make the transfer of client assets from a failing firm to another financial institution easier because restrictions on transfers will be removed, including removing any restriction affecting what can or cannot be assigned as well as any requirement to obtain client consent. The draft Amending SAR Regulations also improve the bar date mechanism and provide for continuity of services for the safe custody of client assets. The draft Amending SAR Regulations are subject to Parliamentary scrutiny. They are expected to come into force in February 2017.

The amending SAR Regulations are available at: http://www.legislation.gov.uk/ukdsi/2017/9780111153222/pdfs/ukdsi_9780111153222_en.pdf.

Funds

European Securities and Markets Authority Opines on Common Principles for the Creation of Share Classes in UCITS

On January 30, 2017, ESMA published its Opinion on the extent to which different types of units or shares (share classes) of the same Undertakings in Collective Investment in Transferable Securities fund should differ from one another. There is currently no common framework across the EU for share classes. Some member states prohibit the set-up of different share classes within a single fund while others permit varying degrees of flexibility. Investors in a UCITS fund invest in a common pool of assets, individual share classes or sub-sets of investors can be attributed different rights although there is no legal segregation of assets between the share classes. ESMA sets out four high-level principles in its Opinion which apply when different share classes are set.

The first principle is the "common investment objective": share classes of the same fund should have a common investment objective reflected by a common pool of assets. ESMA is of the view that hedging arrangements at a share class level (with the exception of currency risk hedging) are not compatible with the requirement for a fund to have a common investment objective. The second principle is "non-contagion": UCITS management companies should implement appropriate procedures to minimize the risk that features specific to one share class could have a potentially adverse impact on other share classes of the same fund. The third principle is "pre-determination": all features of the share class should be pre-determined before it is set up. The fourth principle is "transparency": differences between share classes of the same fund should be disclosed to investors when they have a choice between two or more classes.

ESMA acknowledges that its Opinion will have a significant impact on the investment fund markets in Member States where share class arrangements are allowed where those arrangements do not comply with the four principles. Therefore, ESMA's view is that these share classes should be allowed to continue to operate but should be closed for investment by new investors by July 31, 2017 and for additional investment by existing investors by July 31, 2018.

The Opinion is available at: https://www.esma.europa.eu/press-news/esma-news/esma-advocates-common-principles-setting-share-classes-in-ucits-funds.

Financial Stability Board Publishes Final Recommendations to Address Structural Vulnerabilities From Asset Management Activities

On January 12, 2017, the FSB published a report on policy recommendations to address structural vulnerabilities from asset management activities. The FSB recommendations aim to address four structural vulnerabilities from asset management activities that could cause financial stability risks: (i) liquidity mismatch between fund investment assets and redemption terms and conditions for fund units; (ii) leverage within funds; (iii) operational risk and challenges in transferring investment mandates or client accounts in stressed conditions; and (iv) securities lending activities of asset managers and funds. The FSB makes 14 recommendations, some of which have been amended since the proposed

recommendations were consulted on in the last half of 2016. The recommendations are addressed to national supervisors of asset management activities and to the International Organization of Securities Commissions. Certain types of data are identified that the FSB considers should be collected by national supervisors and/or IOSCO. Steps are specified that national supervisors should take to address the potential financial stability risks. For example, issuing specific guidance to facilitate the use of exception liquidity management tools and the coordination of system-wide stress testing (albeit this is still in an exploratory stage). Another recommended step included requiring asset managers to establish comprehensive risk management frameworks which also cover risks other than the orderly transfer of client accounts and investment mandates.

The report is available at: http://www.fsb.org/wp-content/uploads/FSB-Policy-Recommendations-on-Asset-Management-Structural-Vulnerabilities.pdf?_sm_au_=iVVLpS18qJJN0T1Q.

MiFID II

UK Financial Conduct Authority Publishes Guide on Applications and Notifications for MiFID II

On January 13, 2017, the FCA published a guide on applications and notifications under MiFID and the Markets in Financial Instruments Regulation, together the MiFID II package. MiFID II will apply from January 3, 2018. It will introduce, among other things, new processes and forms for authorizing investment firms and new activities, such as operating an Organised Trading Facility. It will also require notifications to be made to the FCA. The FCA's guide covers applications for investment firm authorizations, new data reporting service providers authorizations, recognition of investment exchanges and variation permission as well as the notifications required by authorized firms and exchanges, including passporting notifications.

In particular, investment firms should note that the FCA will be using new forms for authorizations and variation of permission for investment services and activities from January 30, 2017, and the new passporting notifications from July 31, 2017. All applications for authorization of investment firms and DRSPs or variation of permission must be submitted by July 3, 2017 to allow the FCA time to assess the applications before the MiFID II implementation date. Passporting notifications must be submitted by December 2, 2017 so that the FCA can send them to other EU regulators before January 3, 2018.

The information in the guide is currently up to date. The FCA intends to provide updates on processes for applications and notifications, where necessary, through its website.

The guide is available at: https://www.fca.org.uk/publication/documents/mifid-ii-application-notification-guide.pdf.

Payment Services

US Federal Reserve Board Issues Report on Efforts to Improve the US Payment System

On January 26, 2017, the US Federal Reserve Board issued a progress report which outlined accomplishments and anticipated future steps related to the ongoing initiatives that the Federal Reserve Board has underway to enhance the speed, efficiency and security of the US payment system. The progress report highlights collaborative efforts that are being pursued by the Federal Reserve Board in conjunction with various private sector businesses, financial services providers, financial institutions, consumer groups and government agencies in furtherance of the strategies outlined in the January 2015 publication of "Strategies for Improving the US Payment System." The progress report details the work-to-date and future plans of two payments industry task forces that have effectuated the initiatives—one devoted to faster payments and the other to a more secure payment system.

The progress report is available at: https://www.federalreserve.gov/newsevents/press/other/sips-progress-report-201701.pdf.

UK Government Consults on Implementing the Revised EU Payment Services Directive

On February 2, 2017, the UK Government launched a consultation on implementation of the revised EU Payment Services Directive in the UK. The new Payment Services Directive (known as PSD2) aims to make payments between Member States as secure, easy and efficient as those made within a Member State. PSD2 focuses on electronic payments and payment services within the EU, regulating new types of payment services and payment services providers, which are currently unregulated, and stimulating competition in the electronic payments market.

The Government's consultation comprises a consultation on issues to be considered in implementing PSD2 in the UK and proposed draft regulations. The draft regulations will revoke the existing Payment Services Regulations, although large parts of the new draft regulations will replicate parts of the existing PSRs. Consequential changes will also be required to other UK legislation, including the Electronic Money Regulations 2011. The consultation is relevant to banks, building societies, e-money institutions, payment institutions and payment users.

The Government is seeking feedback on its overall approach to implementation which is to adopt a copy out approach while continuing the use of derogations exercised in the implementation of the existing PSD. The Government is also seeking feedback on particular topics such as the scope of PSD2, authorization, capital and prudential requirements for payment institutions, transparency and the requirements on the provision of information to payment service users, conduct of business rules for payment service providers and implementation of the new rules on rights of payers to use third-party firms providing account information services and payment initiation services.

PSD2 will appeal the current PSD with effect from January 13, 2018. Member States must adopt and publish implementing laws by January 13, 2018 and apply those laws from that date, subject to certain exceptions and transitional measures. The UK Government is aiming to finalize the implementing legislation for consideration by Parliament in early 2017. Responses the consultation are due by March 16, 2017.

The consultation paper is available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/589023/implementation_of_revised_EU_directive.pdf; and the proposed draft legislation is available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/588961/Annex_B.pdf.

Shadow Banking

Financial Stability Board Sees No Reason to Harmonize Regulatory Approaches to Re-hypothecation of Client Assets

On January 25, 2017, the FSB published a Report on regulatory approaches to re-hypothecation of client assets. The Report is in response to the recommendation that the possibility of harmonizing client asset rules with regard to re-

hypothecation should be examined as per Policy Recommendation 8 of the FSB's Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos. The FSB's conclusion is that there is no immediate rationale for harmonizing regulatory approaches to re-hypothecation of client assets. The FSB encourages its member jurisdictions to implement the recommendation in the Policy Framework (Recommendation 7), which provides that authorities should ensure that regulations governing re-hypothecation of client assets should encompass three principles relating to sufficient disclosure to clients, use of client assets that may be re-hypothecated and limitations on the ability to re-hypothecate client assets.

The Report is available at: http://www.fsb.org/wp-content/uploads/Re-hypothecation-and-collateral-re-use.pdf; and the FSB Policy Framework is available at: http://www.fsb.org/wp-content/uploads/r_130829b.pdf.

Financial Stability Board Finalizes Measure and Metrics of Non-Cash Collateral Re-Use in Securities Financing Transactions

On January 25, 2017, the FSB published the final measure and metrics for non-cash collateral re-use in securities financing transactions. The measure and metrics are part of the FSB's global securities financing data collection initiative, the Standards for which were published in November 2015. The Standards identify a data element on collateral re-use eligibility to be collected for collateral received or posted for SFTs by national regulators to be provided (on an aggregated national/regional level) to the FSB. The globally aggregated data on re-use of collateral will be used to assess global trends in non-cash collateral re-use and to monitor the degree of interconnectedness in the collateral markets and the build-up of leverage.

The FSB's Report sets out the collateral re-use measure—which will only cover SFTs—and the data elements required for computing the collateral re-use measure and the associated metrics. The FSB notes that national authorities might require reporting entities to compute the collateral re-use measure themselves rather than just the underlying data. Many FSB members are currently working on the operational arrangements to initiate the official data collection and aggregation from end-2018 data. Data related to collateral re-use will be transmitted by FSB members to the FSB for global aggregation from January 2020. The FSB will review the measure and metrics of collateral re-use five years after the launch of the global data collection with regard to collateral re-use measures. The FSB encourages national authorities to consider monitoring collateral re-use activities beyond SFTs, as appropriate.

The Report is available at: http://www.fsb.org/wp-content/uploads/Non-cash-Collateral-Re-Use-Measures-and-Metrics.pdf.

People

US Securities and Exchange Commission Chief Operating Officer to Resign

On January 27, 2017, the Chief Operating Officer of the US Securities and Exchange Commission, Jeffrey Heslop, announced that he will depart the agency in February. Kenneth Johnson, SEC Chief Financial Officer, will become the Acting COO.

US Commodity Futures Trading Commission Staff Changes

On January 26, 2017, Acting Chairman of the US Commodity Futures Trading Commission Giancarlo announced that the CFTC's General Counsel, Jonathan L. Marcus, is leaving the agency. Mr. Marcus joined the agency in 2011 as Deputy General Counsel for Litigation, and was promoted to General Counsel in 2013. Robert A. Schwartz, currently the Deputy General Counsel for Litigation and Adjudication, will become the Acting General Counsel.

On January 27, 2017, Acting Chairman Giancarlo announced several additional staff changes at the Commission:

- Amir Zaidi has been appointed to lead the Division of Market Oversight.
- Vincent McGonagle has been named as the Acting Director for the Division of Enforcement.

- Jeffrey Bandman will step down from his role as Acting Director of the Division of Clearing and Risk to become an advisor on issues related to Financial Technology (FinTech). John Lawton, a 36-year employee of the Commission, has taken over as Acting Director of the Division of Clearing and Risk.

Upcoming Events

February 27, 2017: EBA public hearing on proposed Guidelines on the supervision of significant branches

March 13, 2017: FSB consultation on proposed Guidance on CCP resolution and resolution planning

March 31, 2017: ESMA consultation on proposed Guidelines on the transfer of data between trade repositories

Upcoming Consultation Deadlines

February 10, 2017: FSB consultation on draft Guidance on continuity of access to financial market infrastructures for a firm in resolution

February 10, 2017: EBA consultation on draft Guidelines on the application of the IRB Approach (probability of default estimation, LGD estimation and treatment of defaulted assets)

February 13, 2017: Comments on US Federal Reserve Board proposal to fully apply the Federal Reserve Board's existing rating system for bank holding companies to savings and loan holding companies.

February 15, 2017: FCA call for input into its review of high-cost credit, including the high-cost of short-term credit (HCSTC) price caps

February 16, 2017: ESMA consultation on proposed amendments to the RTS on trade repository data

February 20, 2017: FCA consultation on remedies to issues identified in the Interim Report on Asset Management Market Study

February 22, 2017: Basel Committee consultation on proposed revisions to the correspondent banking and account opening annexes of its Committee Guidelines on sound management of risks related to money laundering and financing of terrorism

February 27, 2017: PRA consultation on implementation of MiFID II – Part II

March 7, 2017: EBA consultation on draft Guidelines on major incidents reporting under PSD2

March 7, 2017: FCA consultation on enhancing conduct of business rules for firms providing CfD products to retail clients

March 16, 2017: HM Treasury consultation on implementing the revised EU Payment Services Directive in the UK

March 17, 2017: European Supervisory Authorities consultation on the use of big data by financial institutions

March 20, 2017: EBA consultation on proposed Guidelines on the supervision of significant branches

March 31, 2017: FCA consultation on the future funding of the Financial Services Compensation Scheme as well as changes to the FSCS rules

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:

Contacts

BARNEY REYNOLDS
T: +44.20.7655.5528
barney.reynolds@shearman.com
London

REENA AGRAWAL SAHNI
T: +1.212.848.7324
reena.sahni@shearman.com
New York

RUSSELL D. SACKS
T: +1.212.848.7585
rsacks@shearman.com
New York

THOMAS DONEGAN
T: +44.20.7655.5566
thomas.donegan@shearman.com
London

DONNA M. PARISI
T: +1.212.848.7367
dparisi@shearman.com
New York

NATHAN J. GREENE
T: +1.212.848.4668
ngreene@shearman.com
New York

GEOFFREY B. GOLDMAN
T: +1.212.848.4867
geoffrey.goldman@shearman.com
New York

JOHN ADAMS
T: +44.20.7655.5740
john.adams@shearman.com
London

CHRISTINA BERLIN
T: +1.202.508.8028
christina.berlin@shearman.com
Washington, DC

TIMOTHY J. BYRNE
T: +1.212.848.7476
tim.byrne@shearman.com
New York

AYSURIA CHANG
T: +44.20.7655.5792
aysuria.chang@shearman.com
London

TOBIA CROFF
T: +39.02.0064.1509
tobia.croff@shearman.com
Milan

JENNY DING
T: +1.212.848.5095
jenny.ding@shearman.com
New York

ANNA DOYLE
T: +44.20.7655.5978
anna.doyle@shearman.com
London

SYLVIA FAVRETTO
T: +1.202.508.8176
sylvia.favretto@shearman.com
Washington, DC

DANIEL FROST
T: +44.20.7655.5080
daniel.frost@shearman.com
London

CHRISTOPHER HOBSON
T: +44.20.7655.5052
christopher.hobson@shearman.com
London

MAK JUDGE
T: +65.6230.8901
mak.judge@shearman.com
Singapore

JENNIFER SCOTT KONKO
T: +1.212.848.4573
jennifer.konko@shearman.com
New York

HERVÉ LETRÉGUILLY
T: +33.1.53.89.71.30
hletreguilly@shearman.com
Paris

OLIVER LINCH
T: +44.20.7655.5715
oliver.linch@shearman.com
London

BEN MCMURDO
T: +44.20.7655.5906
ben.mcmurdo@shearman.com
London

JENNIFER D. MORTON
T: +1.212.848.5187
jennifer.morton@shearman.com
New York

WILF ODGERS
T: +44.20.7655.5060
wilf.odgers@shearman.com
London

BRADLEY K. SABEL
T: +1.212.848.8410
bsabel@shearman.com
New York

INYOUNG SONG
T: +44.20.7655.5729
inyoung.song@shearman.com
London

KOLJA STEHL
T: +49.69.9711.1623
T: +44.20.7655.5864
kolja.stehl@shearman.com
Frankfurt / London

ELLERINA TEO
T: +44.20.7655.5070
ellerina.teo@shearman.com
London

ABU DHABI | BEIJING | BRUSSELS | DUBAI | FRANKFURT | HONG KONG | LONDON | MENLO PARK | MILAN | NEW YORK | PARIS
ROME | SAN FRANCISCO | SÃO PAULO | SAUDI ARABIA* | SHANGHAI | SINGAPORE | TOKYO | TORONTO | WASHINGTON, DC

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