

FINANCIAL REGULATORY DEVELOPMENTS FOCUS

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

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Bank Prudential Regulation & Regulatory Capital

US Federal Reserve Board Adopts Revised Forms, Including Bank Merger Act Application Form

On March 15, 2018, the U.S. Board of Governors of the Federal Reserve System adopted a proposal to extend for three years, with revisions, certain forms, including the Interagency Notice of Change in Control (FR 2081a), Interagency Notice of Change in Director or Senior Executive Officer (FR 2081b), Interagency Biographical and Financial Report (FR 2081c) and the Interagency Bank Merger Act Application (FR 2070) forms. The revisions to the Interagency Bank Merger Act Application form include additional requested items, such as projected financial statements and capital figures as of the end of each of the first three years of operation following consummation of the merger. In doing so, the Federal Reserve Board noted that the form's prior requirement of one year of projected financial statements was not viewed as sufficient. The Federal Reserve Board also explained that the additional requested items in the revised Bank Merger Act Application form are typically requested in follow-up questions in connection with the application, and that the changes will increase the efficiency with which Bank Merger Act applications are processed. The revisions to the Bank Merger Act Application form also include clarifications, the deletion of certain requested items, definition updates and minor editing changes. The notice highlights that the Federal Reserve Board worked with the U.S. Office of the Comptroller of the Currency and U.S. Federal Deposit Insurance Corporation in drafting the revisions to these forms.

The full text of the Federal Reserve Board notice is available at: <https://www.gpo.gov/fdsys/pkg/FR-2018-03-15/pdf/2018-05255.pdf>.

US House of Representatives Passes Financial Institution Examination Reform Bill

On March 15, 2018, the U.S. House of Representative passed the Financial Institutions Examination Fairness and Reform Act (H.R. 4545) by a vote of 283-133. The bill would amend the Federal Financial Institutions Examination Council Act of 1978 to require federal financial institution regulatory agencies to issue final examination reports within 60 days of the later of a financial institution's exit report or the provision of additional information by a financial institution regarding its examination. The bill would also permit financial institutions to obtain an independent review of material supervisory determinations contained in a final report of examination, including the right to an Administrative Law hearing. The bill would also establish the Office of Independent Examination Review, which, among other things, would receive and investigate complaints from financial institutions with respect to examinations, examination practices and examination reports, review written examination procedures of federal financial regulatory agencies and conduct supervisory appeals.

The full text of the bill is available at: <https://www.congress.gov/115/bills/hr4545/BILLS-115hr4545eh.pdf>.

US Senate Passes Financial Regulatory Reform Bill

On March 14, 2018, the U.S. Senate passed a significant financial services reform bill 67-31 on a bipartisan basis that would eliminate certain requirements of the Dodd-Frank Act, including, most notably, increasing, from \$50 billion to \$250 billion, the threshold at which a large banking organization automatically becomes a systemically important financial institution that is subject to stricter supervisory standards. The Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155) would also (i) exempt banks with less than \$10 billion total consolidated assets from the Volcker Rule; (ii) exempt certain funds placed on deposit with certain central banks by a custodial bank from the calculation of the supplementary leverage ratio; (iii) reduce certain reporting and supervision requirements applicable to community banks; and (iv) ease certain securities law requirements. A number of the provisions of the bill track legislation that has been passed by

the U.S. House of Representatives over the past year, the most significant of which is the Financial Choice Act of 2017, which would amount to an omnibus revision of the Dodd-Frank Act. The House will now have to consider the Senate bill, and the differences between the two bills will likely be negotiated and resolved in a Conference Committee of the House and Senate.

The full text of the bill is available at: <https://www.congress.gov/115/bills/s2155/BILLS-115s2155es.pdf>.

US Financial Stability Oversight Council Amends Procedures for Hearings Conducted Under the Dodd-Frank Act

On March 13, 2018, the U.S. Financial Stability Oversight Council approved certain amendments to its procedures for hearings under Titles I and VIII of the Dodd-Frank Act. The amendments add Section 117 of the Dodd-Frank Act to the scope of its hearing procedures, and make other conforming technical and streamlining amendments. Section 117 of the Dodd-Frank Act (the so-called Hotel California provision) applies to certain bank holding companies and provides that in the event one of these entities ceases to be a bank holding company, it shall thereupon be treated as a nonbank financial company subject to supervision by the U.S. Board of Governors of the Federal Reserve System. Section 117 also provides that an entity designated as a nonbank financial company pursuant to this section may request a hearing before the FSOC to appeal this treatment. The amendments are effective immediately, but the FSOC will accept written comments received within 30 days of the publication of the amendments in the Federal Register.

The full text of the FSOC resolution is available at: <https://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/March%2013,%202018,%20Notational%20Vote.pdf>.

US Federal Reserve Board Approves Request to Establish Second Intermediate Holding Company

On February 14, 2018, the U.S. Board of Governors of the Federal Reserve System issued a letter permitting Deutsche Bank AG to establish a second U.S. intermediate holding company to hold its asset management business pursuant to Regulation YY. This is the first time the Federal Reserve Board has used its authority under Regulation YY to permit a foreign banking organization to establish multiple IHCs. In approving Deutsche Bank's request, the Federal Reserve Board found that the regulatory goals of Regulation YY would still be met with the two-IHC structure in this instance, concluding that the two-IHC structure would help streamline the sale of Deutsche Bank's asset management business in the event of a global recovery or resolution scenario. Under Deutsche Bank's proposal, the second IHC would not engage in any activities and would not hold any assets, other than ownership interests in its U.S. asset management business. In the approval letter, the Federal Reserve Board noted that the second IHC would be treated as meeting or exceeding the \$50 billion threshold for the purposes of Regulation YY and thus be subject to the requirements in subpart O of Regulation YY. Moreover the letter noted that while the Federal Reserve Board's expectations for the second IHC would be tailored to the IHC's specific risk profile and activities, it would still expect that the second IHC would fall under the Bank's U.S. risk management framework, including oversight by its U.S. Risk Committee and U.S. Chief Risk Officer. As a condition of the granting of the request, the Federal Reserve Board required Deutsche Bank to enter into a series of commitments. It will also require the second IHC to be subject to the liquidity coverage ratio requirements of Regulation WW and the total loss-absorbing capacity requirements for covered IHCs under Regulation YY. The second IHC will also be deemed an advanced-approaches Federal Reserve Board-regulated institution for the purposes of Regulation Q (and thus, for example, will be subject to the supplementary leverage ratio), but will not be required to calculate risk-weighted assets in accordance with subpart E of Regulation Q (internal ratings and advanced approaches), unless it elects to do so.

The full text of the Federal Reserve Board letter is available at: <https://www.federalreserve.gov/supervisionreg/files/deutsche-bank-reguy-20180214.pdf>.

European Commission Proposes EU Covered Bonds Legislative Package

On March 12, 2018, the European Commission published legislative proposals for a new EU covered bonds framework. The legislative package consists of a proposed Directive on the issue of covered bonds and covered bond public supervision and a proposed Regulation to amend the prudential treatment of covered bonds under the Capital Requirements Regulation. The proposals are part of the EU's Capital Markets Union project and follow from the work of the European Banking Authority in this area, in particular, its 2016 recommendations for an EU covered bonds framework.

The proposed Covered Bonds Directive will apply to covered bonds issued by EU credit institutions, which means that only EU credit institutions will be able to issue covered bonds governed by the framework. Issuers using the EU covered bonds label will need to comply with the proposed Directive but can also use the label with national labels. Covered bonds are debt obligations issued by credit institutions and secured against a ring-fenced pool of assets to which bondholders have direct recourse as preferred creditors. The proposed Directive provides requirements for issuing covered bonds and the structural features of covered bonds, including dual recourse and bankruptcy remoteness. There are also provisions to address liquidity risk through the imposition of a liquidity buffer related to the cover pool and transparency provisions requiring information to be disclosed to covered bond investors. In addition, the proposed Directive provides for supervision at national level of covered bonds.

An equivalence regime for covered bonds issued by third-country credit institution issuers has not been included in the proposed Covered Bonds Directive. The European Commission must report by the end of three years after the proposed Directive applies on whether an equivalence regime could be introduced.

The proposed Covered Bonds Directive will also amend the EU Bank Recovery and Resolution Directive regarding the treatment of covered bond programmes in the case of the insolvency or resolution of the issuer. The reference to covered bonds in the Undertakings for Collective Investment in Transferable Securities Directive for covered bonds issued before the proposed Directive becomes applicable will remain and a new reference to the new Directive is added for those after it becomes applicable.

For banks investing in covered bonds that meet certain criteria, the CRR sets preferential risk weights with reference to the definition of covered bonds in the UCITS Directive. The proposed amendments to the CRR would introduce additional requirements on covered bonds for banks to be able to benefit from that preferential capital treatment by reference to the definition, governance and transparency provisions in the new Covered Bonds Directive. In particular, it is proposed that a new requirement on a minimum level of over-collateralization would be introduced, the level of which is in line with the EBA's advice—although lower than Basel standards. In addition, provisions allowing, under certain conditions, covered bonds to be collateralized by senior units issued by French Fonds Communs de Titrisation or equivalent entities governed by a Member State's laws that securitize residential or commercial property exposures would be repealed along with the related national derogation to waive the own funds requirement for certain covered bonds. This derogation was only made permanent in November 2017, although it was indicated in the recitals to that legislation that the derogation could be revoked under the revised EU covered bonds framework.

It is intended that the proposed Directive and the proposed amendments to the CRR would apply from the same date, proposed to be one year after the Covered Bonds Directive enters into force. Both legislative proposals are now subject to consideration by the EU co-legislators. Transitional measures in the proposed Directive will allow covered bonds issued before the Directive applies and which comply with the UCITS Directive not to be subject to new requirements. However, those covered bonds will be able to continue to be referred to as covered bonds in accordance with the new Directive until their maturity.

Feedback on the proposed legislative package can be provided through the Commission's website until May 11, 2018.

The proposed Covered Bonds Directive is available at: https://ec.europa.eu/info/law/better-regulation/initiatives/com-2018-94_en?_sm_aui=iVV7FZr2Vt7nFJMM and the proposed amendments to CRR are available at: https://ec.europa.eu/info/law/better-regulation/initiatives/com-2018-93_en and the EBA's 2016 recommendations are available at: <http://finreg.shearman.com/the-european-banking-authority-published-recommen>.

European Commission Consults on Implementing the Final Basel III Requirements

On March 16, 2018, the European Commission opened an exploratory consultation on implementing the final aspects of Basel III into EU law, which will require changes to the Capital Requirements Directive and the Capital Requirements Regulation. Basel III was finalized on December 7, 2017. The final package revises the standardized and Internal Ratings-Based approach for credit risk, the Credit Valuation Adjustment risk framework, the leverage ratio framework, including the introduction of a leverage buffer for Global Systemically Important Banks, the operational risk framework and the new output ratio floor. The revised standards are due to take effect from January 1, 2022 and will be phased in over five years.

The European Commission is seeking feedback on the various elements of the Basel III package, including how the revisions will impact the EU banking sector and wider economy, how they compare to the current EU requirements and whether they pose any particular implementation challenges. The Commission's consultation closes on April 12, 2018.

The consultation paper is available at: https://ec.europa.eu/info/sites/info/files/2018-basel-3-finalisation-consultation-document_en.pdf, the response form is available at: <https://ec.europa.eu/eusurvey/runner/finance-2018-basel-3-finalisation?surveylanguage=en> and the final Basel II package is available at: <http://finreg.shearman.com/basel-iii-finally-finalized>.

Bank of England Publishes Details of its 2018 Stress Test

On March 16, 2018, the Bank of England published a report entitled "Stress testing in the U.K. banking system: key elements of the 2018 stress test," providing details of the Annual Cyclical Scenario, which is the only stress test that the BoE will conduct in 2018. The report is accompanied by detailed guidance for participating banks and building societies. The ACS will examine the impact on participant banks and building societies of three types of severe stress, which will be assumed to be synchronised. These are: (i) a U.K. and global macroeconomic stress; (ii) a traded risk stress (linked to a financial market scenario consistent with the macroeconomic scenario); and (iii) an independent misconduct costs stress. Seven banks and building societies will participate in the 2018 ACS. The report states that these participants account for around 80% of the outstanding stock of lending to the U.K. real economy by banks regulated by the Prudential Regulation Authority.

Aspects of the 2018 ACS will be the same as in the 2017 stress test. However, the hurdle rates (the minimum thresholds above which participants will be expected to maintain their capital positions in a stress scenario) will differ. The BoE expects to publish the results of the stress test in Q4 2018.

The report is available at: <https://www.bankofengland.co.uk/-/media/boe/files/stress-testing/2018/stress-testing-the-uk-banking-system-key-elements-of-the-2018-stress-test.pdf> and the guidance for participating banks and building societies is available at: <https://www.bankofengland.co.uk/-/media/boe/files/stress-testing/2018/stress-testing-the-uk-banking-system-2018-guidance.pdf>.

Conduct & Culture

UK Banking Standards Board Publishes Principles for Strengthening Professionalism

On March 12, 2018, the Banking Standards Board published the “BSB Statement of Principles for Strengthening Professionalism – The role of the firm,” which is a guiding statement of principles intended to assist banks and building societies to strengthen professionalism in the banking sector. The BSB has defined professionalism in U.K. banking as “attitudes, judgement and high standards of behaviour, knowledge and skill expected of individuals working in banking.” The Statement consists of six principles, each of which is supported by action points on how the principle can be achieved.

The Statement does not impose any legal or regulatory obligations on firms or replace any regulation. It is intended to assist firms in structuring their own practices and to build on regulatory initiatives, such as the Senior Managers and Certification Regimes.

The BSB Statement of Principles is available at: <https://www.bankingstandardsboard.org.uk/bsb-statement-of-principles-for-strengthening-professionalism/>.

UK Banking Standards Board Publishes Annual Review for 2017–2018

On March 14, 2018, the BSB published its Annual Review for the year 2017–2018. The BSB is a non-statutory organization established in April 2015 to help raise standards of behaviour and competence across the U.K. banking sector. Voluntary membership of the BSB is open to all banks and building societies operating in the U.K. The Annual Review sets out the key findings of the second annual assessment exercise conducted at member firms.

The BSB uses quantitative and qualitative data to assess firms against an Assessment Framework to establish how far each of nine characteristics is demonstrated within each firm. These characteristics are honesty, competence, reliability, responsiveness, personal/organizational resilience, accountability, openness, respect and shared purpose. The quantitative aspect of the assessment consists of an employee survey asking 37 core questions that allow comparison across and between firms and over time. The qualitative aspect incorporates views and perspectives from all levels and parts of the firm, obtained by various means, including written submissions, interviews and focus groups.

The Annual Review also sets out the priorities the BSB will focus on in 2018. These include:

- Conducting the Assessment for the third time, with a greater number of firms.
- Launching an Insights Unit to identify and understand cultural factors that enable, promote or inhibit high standards in banking.
- Creating a Member Panel, comprised of senior practitioners from member firms, to discuss ways to raise standards of professionalism, referencing the BSB’s Professionalism Principles, which were published in March 2018.
- Delivering a second series of the ethnography workshops it held in 2017, following positive feedback.
- Continuing work on reducing the gap between values and how business is done; encouraging a culture of accountability and responsibility and improving employee wellbeing.

- Publishing a response to its November 2017 consultation on what good banking outcomes look like to consumers.

The Annual Review is available at: <https://www.bankingstandardsboard.org.uk/pdf/banking-standards-annual-review-2017-2018.pdf> and the November 2017 consultation is available at: <http://finreg.shearman.com/uk-banking-standards-board-consults-on-what-good->.

FinTech

European Supervisory Authorities Issue Final Report on Financial Institutions' Use of Big Data

On March 15, 2018, The Joint Committee of the European Supervisory Authorities published a final report on the use of Big Data by financial institutions. The Final Report has been prepared following feedback to a discussion paper published in December 2016 by the Joint Committee's sub-Committee on Consumer Protection and Financial Innovation. "Big Data" is the term used to refer to situations where high volumes of different types of data, produced with high velocity from a wide variety of data sets and sources, is processed (often in real time) by IT tools, such as powerful processors, software and algorithms. Big Data tools have been in use for several years in some sectors, but less so in others. Nevertheless, most respondents to the ESAs' discussion paper agreed that Big Data may have an impact on almost all financial institutions and on their products and services. The use of Big Data techniques can help financial institutions to improve their understanding of customers' preferences and their interactions with customers and clients. This can enable them to tailor products to their target markets and support effective product governance. However, the use of Big Data also entails risk, for example that the data collected is inaccurate (with the result that predictions based on it are flawed), that increased use could bring greater cyber risks and that a lack of transparency in institutions' use of Big Data may make it difficult for consumers to be able to understand or control the use of their personal data.

The ESAs (that is, the European Securities and Markets Authority, the EBA and the European Insurance and Occupational Pensions Authority) consider that legislative intervention regarding financial institutions' use of Big Data is not needed at this point, given that existing sectoral and data protection legislation already provides a framework to mitigate the risks from Big Data. The ESAs also note that the existing framework is (or will be) strengthened further by recent and forthcoming legislation, namely the Insurance Distribution Directive, the revised Markets in Financial Instruments legislation, the revised Payment Services Directive and, in the area of data protection, the General Data Protection Regulation.

The ESAs propose to monitor, on an ongoing basis, the use of Big Data in the financial sector, including engaging with data protection authorities, to assess whether the current framework adequately addresses the identified risks. The ESAs also invite financial institutions to develop best practices on the use of Big Data that will ensure Big Data strategies are fully aligned with the interests of customers and that customers are treated in a fair, transparent and non-discriminatory way. The Final Report sets out an indicative list of arrangements and behaviors that financial institutions should consider when developing good practices. These relate to consumer protection, disclosures on the use of Big Data and robust processes and algorithms.

The Final Report is available at:

<http://www.eba.europa.eu/documents/10180/2157971/Joint+Committee+Final+Report+on+Big+Data+%28JC-2018-04+%29.pdf> and the December 2016 Discussion Paper and Responses are available at: <https://www.esma.europa.eu/press-news/consultations/joint-committee-discussion-paper-use-big-data-financial-institutions>.

European Banking Authority Publishes FinTech Roadmap

On March 15, 2018, the EBA published a Roadmap setting out its conclusions following responses to its August 2017 discussion paper on its approach to financial technology. The EBA adopts the definition of FinTech that is used by international standard-setting bodies, namely, “technologically enabled financial innovation that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services.”

Regulators and supervisors must balance, on the one hand, the needs for consumer protection, a level playing field, the integrity of financial markets and the stability of the financial system against, on the other hand, the need to ensure the opportunities presented by FinTech can be fully realized.

In the August 2017 discussion paper, the EBA set out proposals for further work in the following areas: authorizations and regulatory sandbox regimes; prudential risks for credit institutions, payment institutions and e-money institutions; the impact of FinTech on business models; consumer protection and retail conduct of business issues; the impact of FinTech on the resolution of credit institutions and investment firms and the impact of FinTech on anti-money laundering and countering the financing of terrorism. The Roadmap sets out the EBA’s responses to the feedback it received on the discussion paper and the EBA’s next steps, including an indicative timetable for completion of its further work. The EBA’s 2018/2019 priorities are:

- Authorization and regulatory perimeter issues—the EBA expects to publish a report (and an opinion if appropriate), before the end of 2018, on its assessment of the regulatory treatment of FinTech firms, including authorization and perimeter issues. The report will include, where appropriate, best practices and recommendations on the need, if any, for adaptations to EU financial services legislation to ensure a proportionate, technologically neutral approach to licensing of FinTech firms.
- Regulatory sandboxes and innovation hubs—the EBA will conduct a further survey of national regulators to build on assessments it has already made, and will report by the end of 2018 on the outcome of that survey. It may also produce an opinion and/or proposals to promote best practices to enhance supervisory consistency in the operation of regulatory sandboxes. The EBA will work in close cooperation with the other ESAs on this workstream.
- FinTech’s impact on incumbent business models and new prudential risks and opportunities for incumbent institutions—the EBA has recognized that more dialogue with industry may be needed to understand the practical application of FinTech, changes to incumbent institutions’ business models and risk profiles and potential financial stability issues (for example, from virtual currencies). The EBA proposes to publish thematic reports during 2018 to provide an overview of the current landscape and key trends in the EU internal market, along with a summary of supervisory views on prudential risks and the opportunities for financial sector institutions.
- Cybersecurity—given that cybersecurity is a broader issue than FinTech, the EBA proposes to continue its work on cybersecurity under the broader scope of its work on ICT security. This work will focus on producing ICT guidelines (including for mitigation of cybersecurity risk) for credit institutions and investment firms, harmonizing supervisory practices for the management of cybersecurity risk in credit institutions, investment firms, payment institutions and e-money institutions and evaluating the development of an intelligence-led cyber threat testing framework.
- Consumer protection—the EBA proposes to include, in its report on authorization and perimeter issues, an assessment of the conduct of business requirements applicable to FinTech firms, to ensure an adequate level of consumer protection. The EBA will also focus, during 2018–2019, on cross-border issues,

disclosures to consumers, automation in advice, the availability of dispute resolution mechanisms and issues of financial exclusion in the context of big data algorithms. The EBA will further continue to monitor big data, financial literacy initiatives and the interaction of the revised Payment Services Directive with the General Data Protection Regulation and will continue to monitor developments at EU in respect of electronic identification.

- AML/CFT—the EBA will continue to engage jointly with the other ESAs in this area, continuing an ongoing joint fact-finding exercise to identify the money laundering and terrorist financing risks associated with innovative solutions and FinTech. The results of the exercise may inform further work by the EBA.
- Knowledge sharing—the EBA proposes to form a FinTech Knowledge Hub in 2018. The Hub will provide a forum to facilitate sharing of information and experience and promote knowledge of emerging trends among EU national regulators.

The EBA FinTech Roadmap is available at:

<http://www.eba.europa.eu/documents/10180/1919160/EBA+FinTech+Roadmap.pdf> and the August 2017 discussion paper is available at: <http://finreg.shearman.com/european-banking-authority-discussion-paper-on-it>.

International Standard Setters Report on the Implications of Central Bank Digital Currencies

On March 12, 2018, the Committee on Payments and Markets Infrastructures and the Markets Committee of the Bank for International Settlements issued a joint report that considers two types of central bank digital currency: (i) a wholesale CBDC for use in financial markets and limited to select financial institutions; and (ii) a general purpose CBDC that would be available for use by the public. The report analyses the implications of both types of digital currency in the core central banking areas of payments, monetary policy implementation and financial stability.

As regards wholesale CBDCs, the report finds that while they might be useful for payments, more work is needed to assess their full potential. The report also finds that a wholesale CBDC would not alter the basic mechanics of monetary policy implementation, but that its transmission could be affected. The report states that a general purpose CBDC could have wide-ranging implications for banks and the financial system and could also have effects on the efficiency of financial intermediation. As a result, the report concludes that any jurisdiction considering the launch of a CBDC should carefully and thoroughly consider the implications before making any decision.

The joint report has been published in advance of the meeting of G20 central bank governors and finance ministers, scheduled for March 19–20, 2018, which, among other things, proposes to discuss the technology behind cryptocurrencies.

The joint report is available at: <https://www.bis.org/cpmi/publ/d174.pdf> and the press release is available at: <https://www.bis.org/press/p180312.htm>.

Funds

EU Legislative Package for Cross-Border Distribution of Investment Funds

On March 12, 2018, as part of its work on creating a European Capital Markets Union, the European Commission published a legislative package of amendments, comprising a proposed Regulation and a proposed Directive.

The proposed Directive amends the Directive on Undertakings for Collective Investment in Transferable Securities Directive and the Alternative Investment Fund Managers Directive by introducing new or amending existing elements of that legislation. This includes deletion or amendment of provisions of the UCITS Directive or AIFMD that are dealt with in the proposed new Regulation. The proposed Directive also inserts a definition of “pre-marketing” in AIFMD, which is designed to allow AIFMs to target investors by testing their appetite for upcoming investment opportunities or strategies through pre-marketing. Pre-marketing is defined as “a direct or indirect provision of information on investment strategies or investment ideas... in order to test [investor] interest” in an AIF that has not yet been established.

The proposed Regulation aims to increase transparency on the rules and procedures applicable to cross-border marketing of investment funds and regulatory fees and charges levied by national competent authorities. It comprises:

- requirements on AIFMs or UCITS management companies in respect of marketing communications;
- a new transparency framework for national provisions on marketing requirements, which will require national regulators to publish online all applicable national laws, regulations and administrative provisions governing marketing rules for AIFs and UCITS;
- provisions for national regulators on verification of marketing communications for UCITS and AIFs;
- common principles for fees or charges levied by national regulators; and
- responsibility for ESMA for developing and maintaining databases on national marketing requirements, regulatory fees and charges and notifications and, as part of the database on regulatory fees and charges, launching an interactive tool that would allow stakeholders to calculate the amount of regulatory fees for each Member State.

The proposed Regulation also includes amendments to the European Venture Capital Funds Regulation and the European Social Entrepreneurship Funds Regulation, to introduce the concept of pre-marketing.

The Commission believes that the proposed legislative package will eliminate current regulatory barriers and make cross-border distribution less costly. According to an impact statement published alongside the proposals, the proposed measures are expected to reduce costs for existing cross-border distribution by up to EUR 440 million annually.

The Commission’s proposals will now be discussed by the European Parliament and the Council.

The proposed Directive is available at: <http://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-92-F1-EN-MAIN-PART-1.PDF>, the proposed Regulation is available at:

<http://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-110-F1-EN-MAIN-PART-1.PDF> and the Impact Assessment is available at: <http://ec.europa.eu/transparency/regdoc/rep/10102/2018/EN/SWD-2018-54-F1-EN-MAIN-PART-1.PDF>.

Payment Services

EU Legislation on Strong Customer Authentication Published

On March 13, 2018, a Commission Delegated Regulation was published in the Official Journal of the European Union. The Delegated Regulation supplements the revised Payment Services Directive with Regulatory Technical Standards for strong customer authentication and common and secure open standards of communication.

PSD2 requires that strong customer authentication is used for accessing a payment account online, initiating a payment transaction and carrying out a transaction through a remote channel. “Strong customer authentication” means an authentication based on the use of two or more elements categorized as knowledge (something only the user knows), possession (something only the user possesses) and inherence (something the user is) that are independent, in that the breach of one does not compromise the reliability of the others, and is designed in such a way as to protect the confidentiality of the authentication data.

The RTS set out the requirements on Payment Service Providers to apply the strong customer authentication procedure under PSD2 and also provide detail on the exemptions from the requirements. The RTS also contain provisions to protect the confidentiality and integrity of the personalized security credentials of Payment Services Users, including requirements for masking and encryption of personalized security credentials and secure delivery of credentials, authentication devices and software to the PSU. Finally, the RTS establish common and secure open standards for communications between account servicing PSPs, Payment Initiation Service Providers, Account Information Service Providers, payers, payees and other PSPs in relation to the provision and use of payment services under PSD2.

The Delegated Regulation enters into force on March 14, 2018 and will apply directly across the EU partly from March 14, 2019 and mainly from September 14, 2019.

The Commission Delegated Regulation (EU) No 2018/389 is available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0389&from=EN>.

HM Treasury Consults on Cash and Digital Payments in the New Economy

On March 13, 2018, HM Treasury published a call for evidence which aims to inform the government’s understanding of cash and digital payments in the new economy. Statistics show that the advance of digital technology has impacted how people manage their finances, with a large increase in the use of digital payments and a decrease in the use of cash. The U.K. Government is seeking input on how it can support the transition from cash to digital payments. The Government would like to ensure that cash remains available and secure to those who need to use it. In addition, the Government is concerned with how it can do more to prevent cash being used illegitimately, mostly to evade tax and to launder money.

Responses to the consultation should be provided by June 5, 2018.

The call for evidence is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/689234/Cash_and_digital_payments_in_the_new_economy.pdf.

UK Payment Systems Regulator Consults on Reviewing its Directions on Access, Governance and Participants’ Relationships with the PSR

On March 14, 2018, the U.K. Payment Systems Regulator published a consultation on a review of the six formal General Directions (Directions GD 1-6) and one Specific Direction (SD1) it adopted in 2015 under the Financial Services (Banking Reform) Act 2013. These Directions were all intended to improve access to and the governance of payment systems in the U.K. GD1 sets out the PSR’s expectations of regulated participants in payment systems to have an open and co-operative relationship with it. GD2, GD3 and SD1 set out requirements on operators relating to access to interbank and card payment systems and GD4-6 set out requirements for the governance of interbank payment systems.

Since the Directions were adopted in 2015, the PSR has gained experience of applying the Directions in practice and there have been a number of market and legislative changes, including the introduction of the Payment Services Regulations 2017. The PSR considers that the Directions should now be reviewed to reflect

these market and legislative developments and to ensure that they remain relevant, proportionate and correctly targeted. The consultation paper sets out each of the Directives along with the PSR's proposals to revoke, revise or retain the Direction in its current form.

The PSR invites comments on the proposals by June 8, 2018.

The consultation paper (PSR CP18/1) is available at: <https://www.psr.org.uk/sites/default/files/media/PDF/PSR-CP18-1-Review-of-Directions-March-2018.pdf>.

Securities

European Commission Proposes Legislation to Provide Legal Certainty for Cross-Border Assignment of Claims

On March 12, 2018, the European Commission published a proposed Regulation on the law applicable to the third-party effects of assignments of claims. The proposed Regulation was published alongside a Communication on the law applicable to the proprietary effects of transactions in securities.

Existing conflicts of law rules as to the contractual elements of the assignment of claims are governed at EU-level by the Rome 1 Regulation. However, there are no EU-level conflicts of law rules on the proprietary elements (or third-party effects) of the assignment of claims. The proprietary elements relate to who has ownership rights over a claim, which requirements must be met by an assignee to give him legal title over the claim and the resolution of competing claims. Currently, each Member State's conflicts of law rules govern the assignment of claims. These rules are inconsistent across the EU because they use different connecting factors to determine the applicable law—the rules in some Member States are based on the law of the assigned claim, others are based on the law of the assignor's habitual residence and other conflicts of law rules are based on the law of the assignment contract. In addition, some conflicts of law rules are unclear, particularly where they are not stated in legislation. Without legal certainty, market participants may not be aware of or choose to ignore the risk and then encounter unexpected losses; or they may mitigate the risk by seeking legal advice which will result in higher transaction costs; or they may be dissuaded by the legal risk, choose to avoid it and miss business opportunities.

The proposed Regulation seeks to address the legal uncertainty and legal risks that exist in cross-border assignments of claims arising from the lack of a uniform EU approach. A claim is the right of a creditor against a debtor to the payment of a sum of money or the performance of an obligation. In an assignment of a claim, the creditor transfers his rights to a claim against a debtor to another person. In cross-border transactions where several national laws could potentially apply, the assignee needs to know which laws apply so that it can ensure compliance and obtain legal title over the assigned claim. The collapse of Lehman Brothers International (Europe) in 2008 and its ongoing administration highlights the challenges that arise when there is legal uncertainty over who owns a claim.

The proposed Regulation provides that the national law designated as applicable under the Regulation can be the law of a Member State or that of a third country. As a general rule, the law of the country where the assignor has its habitual residence will govern the third-party effects of assignments of claims. That general rule is subject to two exceptions, the first of which provides that an assignment would be subject to the law of the assigned claim where the general rule is not suitable. The second exception is designed to enhance the securitization market and allows the assignee and assignor in a securitization to choose the law of the assigned claim.

The proposed Regulation covers traditional claims or receivables, financial claims (claims arising from financial instruments that are not securities) and cash credited to an account in a bank. The proposed

Regulation does not apply to book-entry securities and instruments, the existence or transfer of which presupposes their recording in a register, an account, or centralized deposit system. Those book-entry securities and instruments are governed by the conflicts of laws rules applicable under the Financial Collateral Directive, the Settlement Finality Directive and the Winding-up Directive and are the subject of the Commission's Communication. However, and surprisingly (perhaps involving an error) transfer orders under the Settlement Finality Directive do not seem to be so excluded, creating further legal uncertainties as regards the effects of the proposal for participants in such systems.

The Commission anticipates that the proposed Regulation may result in market participants having to amend their legal documents. The proposed Regulation on the law applicable to the third-party effects of assignments of claims will now proceed through the EU legislative process. It will be directly applicable across the EU once it comes into force, which will be 18 months after it is finalized and published in the Official Journal of the European Union.

The proposed Regulation is available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1520854606250&uri=COM:2018:96:FIN>.

European Commission Provides Clarification on the Law Applicable to the Proprietary Effects of Transactions in Securities

On March 12, 2018, the European Commission published a Communication on the law applicable to the proprietary effects of transactions in securities. The Commission's objective is to clarify the conflicts of law provisions in the Financial Collateral Directive, the Settlement Finality Directive and the Winding-up Directive. These Directives apply to book-entry securities and instruments, the existence or transfer of which presupposes their recording in a register, an account, or centralized deposit system. All three Directives designate the applicable law based on the place of the relevant register or account. However, there is a degree of uncertainty because the provisions in the Directives use different language and because there is diverse interpretation and application of the provisions across the EU.

The Communication confirms the Commission's view that the terms "maintained" and "located" used in these Directives mean the same thing and that the different ways across the EU of determining where the account or register is "maintained" or "located" are valid. The Commission's views are subject to any potential future decisions of the Court of Justice of the European Union on these issues.

The Commission will monitor developments in this area and assess whether any further action is necessary. National authorities are called upon to take the Commission's clarifications into account when applying the conflicts of law provisions of the FCD, SFD or WUD.

The Communication should be read in conjunction with the Commission's proposed Regulation on the law applicable to the third-party effects of assignments of claims.

The Communication is available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2018:89:FIN>.

European Central Bank Publishes Second Consultation on a New Euro Unsecured Overnight Rate

On March 15, 2018, the European Central Bank published a second consultation paper on a new unsecured overnight interest rate for euro transactions. This second consultation follows the ECB's announcement in September 2017 of its intention to develop the new benchmark and an initial consultation in November 2017 on its high level features. The new ECB rate will represent the euro unsecured money market in the very short tenor (i.e. overnight) and will be based entirely on transactions in euro that are reported by banks in accordance with the ECB's money market statistical reporting. It will complement existing benchmark rates

produced by the private sector and serve as a backstop reference rate. The ECB proposes to produce the new rate by 2020.

The second consultation sets out a proposed definition of the underlying interest and scope of the benchmark, based on responses received to the first consultation. On the basis of the proposed definition of the rate's underlying interest, the second consultation considers the defined methodology of the new rate, along with the key operational and technical parameters. The consultation document also proposes contingency calculation rules in case certain representativeness thresholds are not met.

The ECB invites responses to the consultation, via a response template, by April 20, 2018.

The consultation is available at:

http://www.ecb.europa.eu/paym/pdf/cons/euoir/consultation_details_201803.pdf and the response template is available at: http://www.ecb.europa.eu/paym/pdf/cons/euoir/consultation_details_201803.pdf.

UK Financial Conduct Authority Outlines its Policy for Compelling Banks to Contribute to LIBOR

On March 14, 2018, the U.K. Financial Conduct Authority published a policy statement explaining the methodology the FCA would expect to use if it needed to compel banks to contribute to LIBOR (the London Interbank Offered Rate). LIBOR, which is administered by ICE Benchmark Administration, is a long-established and systemically important benchmark that underpins transactions in many different markets globally. The FCA's powers to compel contributions to LIBOR under the Financial Services and Markets Act 2000 have been superseded by similar powers under the EU Benchmarks Regulation, which came into effect on January 1, 2018. LIBOR has been designated a critical benchmark under the Benchmarks Regulation.

The FCA published a consultation paper in June 2017 on how its compulsion powers would need to be amended to align it with the Benchmarks Regulation. Since that consultation, the FCA has announced that all 20 panel banks that currently submit to LIBOR have agreed to continue to do so until the end of 2021. The FCA envisages that, by that time, sufficient progress will have been made on the evolution of LIBOR and transition to alternative benchmarks (which will be based on actual transactions) that the FCA may never need to use its compulsion powers.

The policy statement (FCA PS18/5) is available at: <https://www.fca.org.uk/publication/policy/ps18-05.pdf>.

Upcoming Events

March 20–21, 2018: U.S. Board of Governors of the Federal Reserve System, Federal Open Market Committee meeting – Press conference with Chairman Jerome Powell to follow.

March 21, 2018: U.S. House Financial Services Committee – Markup session to consider a number of bills, including the Volcker Rule Regulatory Harmonization Act (H.R. 4790) and the Small Bank Exam Cycle Improvement Act of 2018 (H.R. 5076).

March 22, 2018: U.K. Government's second annual International Fintech Conference

March 22, 2018: European Commission high-level conference on financing sustainable growth

April 24, 2018: European Central Bank public hearing (via telephone conference) on its consultation on draft guides to ICAAP and ILAAP

April 25, 2018: EBA public hearing on draft EBA Guidelines on Management of Non-Performing and Forborne Exposures

May 31, 2018: Bank of England and Centre for Economic Policy Research conference on competition and regulation in financial markets

Upcoming Consultation Deadlines

March 22, 2018: CMA Working Paper on its investment consultancy services investigation

March 23, 2018: Basel Committee consultation on revised principles for supervisory and bank stress testing

March 23, 2018: FCA consultation on Handbook changes for implementation of the Money Market Funds Regulation

March 27, 2018: CFPB's Civil Investigative Demands request for information

March 30, 2018: U.K. JMLSG consultation on minor changes to its sectoral guidance in relation to asset finance and syndicated lending

April 3, 2018: BoE consultation on new incident reporting rules for CCPs

April 9, 2018: PRA consultation on MREL reporting requirements

April 12, 2018: European Commission consultation on implementing the final aspects of Basel III into EU law

April 20, 2018: ECB Second Consultation on a New Euro Unsecured Overnight Rate

May 4, 2018: IOSCO Consultation – Conflicts of interest and associated conduct risks during the equity capital raising process

May 4, 2018: ECB consultation on draft guides to ICAAP and ILAAP

May 6, 2018: IOSCO consultation on proposed recommendations for trading venues and their regulators when implementing, operating and monitoring volatility control mechanisms to preserve orderly trading

May 7, 2018: PRA consultation on governance and risk management for algorithmic trading

May 11, 2018: FCA survey of European Economic Area firms currently operating in the U.K. under a passport

May 16, 2018: PRA consultation on guidance on the eligibility of guarantees as unfunded credit protection for capital requirement purposes

May 25, 2018: Basel Committee consultation on revisions to Pillar 3 Framework

June 5, 2018: HM Treasury consultation on cash and digital payments in the new economy

June 8, 2018: EBA consultation on draft EBA Guidelines on Management of Non-Performing and Forborne Exposures

June 8, 2018: PSR consultation on its review of PSR Directions made in 2015

June 20, 2018: FCA consultation on Model Driven Machine Executable Regulatory Reporting

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
Partner
London
barney.reynolds@shearman.com



REENA AGRAWAL SAHNI
Partner
New York
reena.sahni@shearman.com



RUSSELL SACKS
Partner
New York
rsacks@shearman.com



THOMAS DONEGAN
Partner
London
thomas.donegan@shearman.com



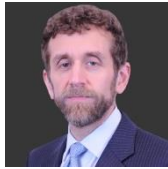
SUSANNA CHARLWOOD
Partner
London
susanna.charlwood@shearman.com



DONNA PARISI
Partner
New York
dparisi@shearman.com



NATHAN GREENE
Partner
New York
ngreene@shearman.com



GEOFFREY GOLDMAN
Partner
New York
geoffrey.goldman@shearman.com



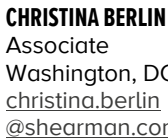
JOHN ADAMS
Partner
London
john.adams@shearman.com



PHILIP UROFSKY
Partner
Washington D.C.
philip.urofsky@shearman.com



ELIAS ALLAHYARI
Associate
London
elias.allahyari@shearman.com



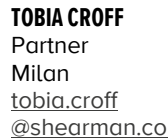
CHRISTINA BERLIN
Associate
Washington, DC
christina.berlin@shearman.com



TIMOTHY J. BYRNE
Counsel
New York
tim.byrne@shearman.com



AYSURIA CHANG
Associate
London
aysuria.chang@shearman.com



TOBIA CROFF
Partner
Milan
tobia.croff@shearman.com



DANIEL FROST
Associate
London
daniel.frost@shearman.com



MATTHEW HUMPHREYS
Associate
London
matthew.humphreys@shearman.com



THOMAS JONES
Associate
London
thomas.jones@shearman.com



JENNY DING JORDAN
Associate
New York
jenny.jordan@shearman.com



P. SEAN KELLY
Associate
New York
sean.kelly@shearman.com



JENNIFER SCOTT KONKO
Associate
New York
jennifer.konko@shearman.com



HERVÉ LETRÉGUILLY
Partner
Paris
hletreguilly@shearman.com



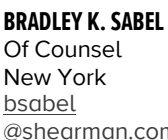
OLIVER LINCH
Associate
London
oliver.linch@shearman.com



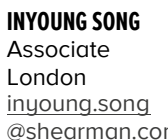
JENNIFER D. MORTON
Counsel
New York
jennifer.morton@shearman.com



WILF ODGERS
Associate
London
wilf.odgers@shearman.com



BRADLEY K. SABEL
Of Counsel
New York
bsabel@shearman.com



INYOUNG SONG
Associate
London
inyoung.song@shearman.com



KOLJA STEHL
Counsel
London
kolja.stehl@shearman.com



ELLERINA TEO
Associate
London
ellie.teo@shearman.com

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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