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FINANCIAL REGULATORY DEVELOPMENTS FOCUS

NOV 30, 2018
ISSUE 47/2018

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

UK Parliamentary Committee Launches Inquiry into Operational Resilience in the Financial Services Sector

On November 23, 2018, the U.K. Treasury Committee announced the launch of a new Inquiry into IT failures in the financial services sector. The Inquiry has been launched in response to recent IT failures at a number of financial institutions that have led to consumers being unable to access their bank accounts or becoming subject to fraud.

The Committee will assess the causes and consequences of these recent IT failures. Among other things, the Committee will consider the extent to which such incidents are becoming more frequent, sources of concentration risk in the financial sector, the impact of legacy IT systems, the effect of outsourcing on operational resilience, best practices in responding to operational incidents and whether the U.K. regulators are able to regulate firms' capabilities for responding to such incidents.

Written submissions can be made to the Committee by January 18, 2019. The Committee will also appoint a special advisor to provide policy advice to the Committee on the issues. Individuals interested in the role should respond to the call for Expressions of Interest.

The announcement is available at: https://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news-parliament-2017/it-failures-in-the-financial-services-inquiry-launch-17-19/.

UK Prudential Regulator Proposes Minor Policy Change for Systemic Risk Buffer

On November 22, 2018, the U.K. Prudential Regulation Authority published a consultation paper entitled "The systemic risk buffer: Updates to the Statement of Policy," proposing minor updates to its Statement of Policy, "The PRA's approach to the systemic risk buffer." The consultation is relevant to "SRB institutions," which are: (i) ring-fenced bodies within the meaning in the Financial Services and Markets Act 2000; or (ii) large building societies that hold more than £25 billion in deposits (where one or more of the account holders is a small business) and shares (excluding deferred shares).

The PRA proposes to amend the Statement of Policy to:

I. remove the statement that the PRA's approach to reviewing the SoP every two years is mandated by the SRB regulations;

II. replace references to the PRA's April 2018 consultation, "The PRA's methodologies for setting Pillar 2 capital," with references to the finalized Statement of Policy that was subsequently published; and

III. include references to the PRA's Supervisory Statement, "U.K. leverage ratio framework," that was recently updated to apply an additional leverage ratio buffer rate to SRB institutions.

As the proposals are of only a minor nature, the consultation period is short and comments on the consultation paper are invited by December 6, 2018.

The consultation paper (PRA CP 29/18) is available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2018/cp2918.pdf.

Brexit for Financial Services

European Supervisory Authority Public Statement on Post-Brexit Temporary Recognition for UK CCPs if No UK-EU Deal

On November 23, 2018, the European Securities and Markets Authority issued a public statement entitled "Managing risks of a no-deal Brexit in the area of central clearing." In the statement, ESMA confirms that its Board of Supervisors supports continued access to U.K. CCPs by EU market participants, to limit the risk of disruption in central clearing and to avoid negatively impacting EU financial market stability following the U.K.'s exit from the EU. This would appear likely to take effect pursuant to a temporary or interim equivalence and/or Qualifying CCP determination under the European Market Infrastructure Regulation and the Capital Requirements Directive for the U.K. and its CCPs, effective on Brexit.

ESMA welcomes the Communication issued by the European Commission on November 13, 2018, in which the Commission stated that it proposed to adopt a temporary and conditional equivalence decision to ensure that there will be no post-Brexit disruption to central clearing in the event of a "no-deal" scenario. ESMA confirms that it is engaging with the European Commission, and has already begun engaging with U.K. CCPs, to carry out preparatory work for a proposed recognition process that will ensure EU clearing members and trading venues can continue to access U.K. CCPs as of March 30, 2019. The recognition process will operate provided that the conditions in EMIR and conditions set out in the equivalence decision are all met.

It remains to be seen whether these helpful not non-legally binding statements of intent give sufficient certainty to enable U.K. clearing houses to determine not to exercise termination notices on EU clearing members prior to the end of the year (in light of applicable termination notice periods).

The ESMA public statement is available at: https://www.esma.europa.eu/sites/default/files/library/esma70-151-1948_managing_risks_of_a_no-deal_brexit_in_the_area_of_central_clearing.pdf and details of the Commission Communication are available at: https://finreg.shearman.com/european-commission-publishes-aspects-of-continge.

UK Conduct Regulator Publishes Second Consultation on Brexit-Related Changes to Its Rulebook and Binding Technical Standards

On November 23, 2018, the U.K. Financial Conduct Authority published a second consultation on proposed changes to the FCA Handbook and guidance to ensure a functioning legal and regulatory framework for financial services in the event of a "no-deal" scenario, whereby the U.K. exits the EU on March 29, 2019 without a ratified Withdrawal Agreement in place, and there is consequently no transitional period for firms. The proposed amendments will not take effect on exit day if the U.K. enters into a transitional period.

The consultation includes the FCA's further proposals in relation to those Binding Technical Standards that it has been empowered by HM Treasury to amend prior to Brexit and to maintain afterwards. Since the FCA's first consultation on Brexit-related Handbook changes in October 2018, HM Treasury has published further policy notes and/or financial services "onshoring" statutory instruments with proposed amendments to retained EU law. Many of the FCA's proposals on the BTS are consequential in nature and follow the amendments proposed in the statutory instruments.

The consultation covers:

I. ***Cross-cutting issues***. The FCA recaps its proposals in its October consultation to deal with the so-called cross-cutting issues that span the Handbook and the BTS. Further cross-cutting issues identified since its October consultation relate to:

a. The Distance Marketing Directive: the FCA has not identified a reason why it should diverge from the baseline approach of treating EEA states in the same way as third countries. Therefore, after exit day, the FCA's DMD-related Handbook provisions will no longer apply to U.K. firms' distance marketing activity involving EEA-based consumers.

b. The E-Commerce Directive: HM Treasury proposes to revoke legislation that relates to the cross-border provision of financial services via the ECD's exemption from host-state regulation. The FCA is making consequential Handbook amendments to reflect this. The result of these changes is that EEA firms conducting cross-border e-commerce activities will not, post-Brexit, be able to sell online-only regulated financial services to U.K. consumers without obtaining U.K. authorization.

II. ***Amendments to Specific Sourcebooks and Chapters in the Handbook***. The consultation paper sets out a detailed overview of the Handbook sourcebooks and chapters covered in the consultation, along with key affected stakeholders. The FCA is, for the most part, making cross-cutting changes consequential on statutory instruments published by HM Treasury since the October consultation. Further explanation is provided in areas where the FCA considers it helpful or where it has deviated, along with HM Treasury, from the baseline approach of treating EEA firms as third-country firms after exit day. These areas are:

a. the FCA's high-level standards covering firms' systems and controls, the Senior Managers and Certification Regime and the Approved Persons Regime;

b. prudential standards for the contractual recognition of bail-in under the U.K. legislation implementing the Bank Recovery and Resolution Directive, where EU law contracts will require such clauses, but only in new contracts or amended contracts after Brexit;

c. business standards relating to motor vehicle liability insurers and the handling of claims;

d. business standards relating to compensation disclosures;

e. Glossary definitions and the scope of certain conduct of business rules;

f. changes to baseline (third-country) approach for the rules on appropriateness assessments for MiFID business, so that the status quo is maintained for EEA Undertakings for Collective Investment in Transferable Securities and for shares and bonds trading on or admitted to trading on EEA Regulated Markets (such financial instruments will continue to be treated as non-complex);

g. the current exemption for manufacturers of UCITS funds from providing a Key Investor Document under the Packaged Retail and Insurance-based Investment Products Regulation will be retained post-exit day;

h. business standards relating to insurance-linked securities;

i. the MiFID tied agent regime will be narrowed to refer only to FCA-registered tied agents (that is, tied agents of U.K. MiFID investment firms that are established in the U.K. but which do not carry on any business in the U.K.);

j. amendments to the Listing, Disclosure and Transparency rules to reflect the U.K.'s post-Brexit primary markets regime that will apply to all issuers that have securities admitted to trading on a U.K. Regulated Market or admitted to listing in the U.K. and to all issuers that are making a public offer of securities in the U.K., in each case irrespective of the issuer's country of incorporation; and

k. a summary of the amendments the FCA expects to make in due course to relevant sourcebooks, once statutory instruments are published to reflect that the U.K. will be excluded, on a "no-deal" Brexit, from the EU's Emissions Trading System.

III. ***The Temporary Permissions Regime for a No-Deal Brexit***. The FCA set out in its October 2018 consultation how it envisaged the Government's proposal to introduce a temporary permissions regime for inbound passported EEA firms and funds would work and on how certain FCA rules would apply to firms with temporary permissions. This consultation sets out further how the FCA envisages that its rules would apply to firms in the regime and sets out the proposed application of rules relating to the SM&CR and the APR, the Financial Services Compensation Scheme, the Financial Ombudsman Service and to authorization status disclosures.

IV. ***Proposed Amendments to BTS for Which the FCA is Solely or Jointly Responsible***. The FCA's October 2018 consultation set out the FCA's proposed changes to some, but not all, of the financial services-related BTS, namely the BTS that relate to credit rating agencies, fund management, trade repositories, MiFID II, short selling and capital requirements. This consultation sets out the FCA's proposed changes and draft EU Exit instruments for almost all of the remainder of BTS for which the FCA is responsible. The finalized EU Exit instruments will need to be approved by HM Treasury. Further detail is provided on the proposed amendments to the BTS for: (i) the trade transparency requirements under the Markets in Financial Instruments Regulation; (ii) the PRIIPs Regulation; (iii) the Insurance Distribution Directive; (iv) the Payment Accounts Directive; (v) the BRRD, Financial Conglomerates Directive and the capital requirements-related BTS; and (vi) EMIR.

A "cut-off" point of 23.59 GMT on October 24, 2018 has been used by the FCA for its consultation, which covers the BTS that have either been published in the Official Journal of the European Union or published in near final form by the European Commission by that time. Where BTS have not yet reached this stage in the EU, adjustments will need to be made at a later date by HM Treasury to onshoring legislation and/or to regulators' powers to amend technical standards. The FCA will need to consult further on those BTS in due course.

V. ***CRAs and Trade Repositories***. The consultation paper sets out FCA's proposals to make minor amendments to its Decision Procedure and Penalties Manual and its Enforcement Guide to reflect the FCA's post-Brexit role as the supervisor of these entities.

VI. ***The FCA's Non-Handbook Guidance***. The FCA confirms in the consultation paper that its existing non-Handbook guidance that relates to EU or EU-derived law will remain relevant post-Brexit. It is consulting on a draft interpretive guide to such material after exit day.

Comments on the consultation are requested by December 21, 2018. The FCA expects to provide feedback on the consultation and publish near-final instruments in early 2019.

The consultation paper (FCA CP 18/36) is available at: https://www.fca.org.uk/publication/consultation/cp18-36.pdf, the feedback form is available at: https://www.fca.org.uk/cp18-36-response-form, details of the FCA's earlier consultation on BTS (FCA CP18/28) are available at: https://finreg.shearman.com/uk-conduct-regulator-consults-on-brexit-related-c, details of the FCA's proposals for a temporary permissions regime (FCA CP 18/29) are available at: https://finreg.shearman.com/uk-conduct-regulator-consults-on-post-brexit-temp and details of the proposed arrangements for CRAs and Trade Repositories are available at: https://finreg.shearman.com/uk-regulator-provides-information-on-brexit-proce.

UK Payment Systems Regulator Consults on Brexit-Related Changes to Onshore Regulatory Technical Standards Under the Interchange Fees Regulation

On November 23, 2018, the U.K. Payment Systems Regulator launched a consultation on its proposals to onshore the Regulatory Technical Standards supplementing the EU Interchange Fee Regulation to ensure the RTS can still operate effectively once the U.K. has left the EU. The consultation will primarily be relevant for card schemes subject to the IFR, parties contracting with card schemes and/or processing entities (e.g., issuers, acquirers) and third-party card payment processors.

The PSR is empowered by HM Treasury, under the Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018, to correct deficiencies in the RTS and to maintain them after exit day. The RTS set out detailed requirements for payment card schemes and processing entities, to ensure there is the requisite level of independence in accounting, organization and decision-making processes. The PSR proposes to amend the RTS in line with the draft Interchange Fee (Amendment) (EU Exit) Regulations 2018, published by HM Treasury on November 16, 2018, to onshore the IFR. The PSR's consultation paper includes a draft of the Technical Standards (Interchange Fee Regulation) (EU Exit) instrument 2019.

Comments on the consultation are invited by December 17, 2018. The PSR intends that the finalized version of the EU Exit instrument will take effect on exit day in the event of a no deal scenario.

The consultation paper (PSR CP 18/3) is available at: https://www.psr.org.uk/sites/default/files/media/PDF/CP_18_3_Onshoring_IFR_RTS_Regulation_November_2018_0.pdf and details of the draft Interchange Fee (Amendment) (EU Exit) Regulations 2018 are available at: https://finreg.shearman.com/draft-uk-legislation-published-to-onshore-the-eu-.

UK Draft Legislation to Onshore EU Packaged Retail and Insurance-Based Investment Products for Brexit

On November 22, 2018, HM Treasury published a draft version of the Packaged Retail and Insurance-based Investment Products (Amendment) (EU Exit) Regulations 2019. The EU PRIIPS Regulation requires a standardized disclosure document (called a Key Information Document or KID) to be provided when packaged investment or insurance-based investment products are sold to retail investors.

The draft Regulations correct deficiencies in the U.K. Packaged Retail and Insurance-based Investment Products Regulations 2017 and in the directly applicable EU PRIIPS Regulation (and its secondary legislation) to be retained on Brexit. The draft Regulations will primarily be relevant for firms that manufacture, sell or advise on retail investment products that fall within the scope of the PRIIPs Regulation. This includes, but is not limited to, asset managers, insurers and investment advisors.

The draft Regulations narrow the scope of the U.K. PRIIPs Regulation so that it applies only to those U.K. or third-country firms that manufacture, advise on or sell PRIIPs to investors in the U.K. Post-Brexit, U.K. firms, that manufacture, advise on or sell PRIIPs to investors in the EU or another third-country will not be subject to the U.K. regime but will be subject to the EU PRIIPs Regulation or third-county regulation.

The draft Regulations ensure that no new products will fall within scope of the U.K. PRIIPs regime on exit day, by excluding from the scope of the U.K. PRIIPs regime any products that are outside the scope of the EU PRIIPs Regulation. The draft Regulations also ensure that, after exit, the U.K. treats EEA countries in the same way as other third countries in relation to the existing EU PRIIPs exemption from the requirement to produce a KID for certain products that are outside the scope of the Prospectus Directive. This exemption will also be extended to include non-EEA third countries. This means that products such as non-equity securities issued or guaranteed by sovereigns and certain public-sector entities or shares issued by central banks in any non-U.K. jurisdiction will be exempt from the KID requirement under the U.K. PRIIPs regime.

A further EU PRIIPs exemption that will be carried through into the U.K. PRIIPs regime is the exemption (expiring December 31, 2019) from the requirement to produce a KID for UCITS. Under the U.K. PRIIPs regime, both U.K. and EEA UCITS will be permitted to continue to produce the UCITS Key Investor Information Document (the UCITS KIID) instead of a KID. Separate onshoring legislation was published for onshoring the UCITS regime.

Functions currently carried out by ESMA and the European Insurance and Occupational Pensions Authority under the EU PRIIPs Regulation will be carried out by the FCA under the U.K. PRIIPs regime. Functions carried out by the European Commission will be transferred to HM Treasury.

HM Treasury intends to lay the draft Regulations before Parliament before exit day. The draft Regulations will enter into force on exit day in a no deal scenario.

Despite the extraordinary difficulties that the PRIIPS regulations have caused for industries that the PRIIPS regulation was not intended to regulate, such as security issuances and exchange-traded derivatives, and the many difficulties created by its prescriptive disclosure regime in terms of under-representing investment risks, there are no current proposals to reform the PRIIPS regime within this present legislation package, which purely implements Brexit. However, this area may be a prime candidate for any future "better regulation" agenda that arises in the U.K.

The draft Regulations are available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/757998/PRIIPS_Draft_SI_Text.pdf, the explanatory information is available at: https://www.gov.uk/government/publications/draft-packaged-retail-and-insurance-based-investment-products-amendment-eu-exit-regulations-2019/packaged-retail-and-insurance-based-investment-products-amendment-eu-exit-regulations-2019-explanatory-information and details of the onshoring legislation for UCITS are available at: https://finreg.shearman.com/draft-uk-post-brexit-legislation-to-onshore-eu-uc.

UK Government Publishes Guidance on Proposals to Onshore EU Market Abuse Regulation for Brexit

On November 21, 2018, HM Treasury has published explanatory information on a draft statutory instrument, the Market Abuse (Amendment) (EU Exit) Regulations 2018. The statutory instrument is still under development and a draft will be published in due course. The draft Regulations will affect the FCA and all natural and legal persons which issue or trade in financial instruments admitted to trading or traded on an U.K. or an EU trading venue, including legal firms, professional service firms and any legal person that obtains access to the inside information of an issuer.

The forthcoming draft Regulations will amend deficiencies in the version of the EU Market Abuse Regulation that will be retained on Brexit (U.K. MAR). The changes in the draft Regulations will take effect on exit day in a no-deal scenario. The draft Regulations will:

I. Transfer the powers of ESMA under EU MAR to the FCA to enable it to enforce U.K. MAR to the extent necessary for a functional U.K. regime.

II. Maintain the existing scope of EU MAR in U.K. MAR. U.K. MAR will therefore continue to capture conduct involving instruments admitted to trading or traded on both U.K. and EU trading venues. The FCA will be able, as far as possible in the event of no deal, to take action in relation to conduct concerning financial instruments which affect U.K. markets and the U.K.'s reputation. This is quite a surprising and questionably justifiable extension of U.K. enforcement jurisdiction for post-Brexit arrangements, since MAR does not cover other major third-country markets that are traded by persons located in the UK.

III. Preserve in U.K. MAR the requirements in EU MAR for certain notifications, disclosures and suspicious transaction reports.

IV. Enable investigation of possible market abuse and enforcement measures under U.K. MAR due to the preservation of the transaction reporting requirements of the onshored MiFID II package.

The explanatory information states that the U.K. MAR introduced by draft Regulations will not result in significant impacts for firms, as it is intended largely to continue the status quo. Issuers, firms and trading venues that currently report to the FCA under EU MAR will continue to report the same information to the FCA under U.K. MAR.

The explanatory information is available at: https://www.gov.uk/government/publications/draft-market-abuse-amendment-eu-exit-regulations-2018/market-abuse-amendment-eu-exit-regulations-2018-explanatory-information

Details of the proposals for onshoring the MiFID II package are available at: https://finreg.shearman.com/draft-uk-post-brexit-legislation-to-onshore-the-e

UK Government Publishes Guidance on Proposals to Onshore Primary Markets Legislation for Brexit

On November 21, 2018, HM Treasury published explanatory guidance on a draft statutory instrument, the Official Listing of Securities, Prospectus and Transparency (Amendment) (EU Exit) Regulations 2019. The statutory instrument is still under development and a draft will be published in due course. The draft Regulations will amend Brexit-related onshoring deficiencies in the U.K. legislation that implemented the EU Prospectus Directive, the Transparency Directive and the Consolidated Admissions and Reporting Directive, which together make up the EU legal framework for primary markets. No deficiencies have been identified for the CARD. The draft Regulations will make the following key changes:

I. The Prospectus Directive. Prospectuses "passported" into the U.K. before exit day will be grandfathered for use in the U.K. until their validity expires. However, passporting of prospectus will not be possible after Brexit. Issuers wishing to access the U.K.'s capital markets for offers to the public or admissions to a regulated market will, post-Brexit, be required to secure approval of prospectuses from the U.K. FCA (regardless of whether they have been approved by a regulator in an EEA member state). The exemption from the requirement to produce a prospectus, which is available to certain public bodies (including EEA states, EEA local authorities, EEA central banks and public international bodies of which one or more EEA states are a member) when they wish to offer certain securities to the public, will be extended to certain third-country public sector bodies and international bodies of which a state is a member.

II. The Transparency Directive. A similar extension to certain third-country public sector bodies will be made to the existing exemption, under the Transparency Directive, from the requirement to make certain ongoing disclosures.

III. Equivalence determinations. HM Treasury will take on the European Commission's function of determining the equivalence of third-country jurisdictions under the PD. HM Treasury will also take on the Commission's functions under the PD and TD of assessing whether third-country jurisdictions' accounting rules meet the necessary standards to be deemed equivalent to the accounting rules adopted by the U.K.

The overall intention of the proposed changes is to preserve, as far as possible, the current effects of the prospectus regime, the transparency rules and the listing rules.

To preserve continuity in a no-deal scenario, given that issuers with securities admitted to trading on a regulated market in the EU are currently required to make use of International Financial Reporting Standards, as adopted by the EU, for their consolidated accounts, HM Treasury intends to issue an equivalence decision

in time for exit day determining that EU-adopted IFRS can continue to be used to prepare financial statements under the Transparency Directive and for preparing a prospectus under the PD. The Department for Business, Energy and Industry Strategy also proposes to lay a statutory instrument before Parliament that gives the U.K. the powers to adopt IFRS on Brexit. Once that SI is published, HM Treasury will need to make consequential amendments to the draft Regulations.

The explanatory guidance is available at: https://www.gov.uk/government/publications/draft-official-listing-of-securities-prospectus-and-transparency-amendment-eu-exit-regulations-2019/draft-official-listing-of-securities-prospectus-and-transparency-amendment-eu-exit-regulations-2019-explanatory-information.

UK Sanctions and Anti-Money Laundering Act 2018 Sanctions Provisions Brought into Force

On November 21, 2018, the Sanctions and Anti-Money Laundering Act 2018 (Commencement No. 1) Regulations 2018 were made, bringing into force the majority of the sanctions provisions of the Act with effect from November 22, 2018.

The Act's provisions empower the U.K. Government to make sanctions regulations to be imposed, where appropriate, to comply with United Nations obligations or other international obligations, to further the prevention of terrorism, for the purposes of national security or international peace and security, or to further foreign policy objectives. The Act also empowers the U.K. Government to create, amend and update regulations for the detection, investigation and prevention of money laundering and terrorist financing and for the purposes of implementing standards published by the Financial Action Task Force relating to combating threats to the integrity of the international financial system.

The Act received Royal Assent and came partly into force on May 23, 2018. The remaining Provisions of the Act that will be brought into force at a later date include the provisions related to anti-money laundering.

The Commencement Regulations (SI 2018/1213) are available at: http://www.legislation.gov.uk/uksi/2018/1213/pdfs/uksi_20181213_en.pdf and the Sanctions and Anti-Money Laundering Act 2018 is available at: http://www.legislation.gov.uk/ukpga/2018/13/pdfs/ukpga_20180013_en.pdf.

UK Legislation Made for Onshoring the EU SEPA Regulation

On November 19, 2018, the Credit Transfers and Direct Debits in Euro (Amendment) (EU Exit) Regulations 2018 were made and will enter into force on the day the U.K. exits the EU. The Regulations are relevant for all Payment Service Providers—banks, payment institutions, e-money institutions and registered Account Information Service Providers.

The Regulations make amendments to the Payments in Euro (Credit Transfers and Direct Debits) Regulations 2012 and to the version of the Single Euro Payments Area Regulation (Regulation (EU) No 260/2012 establishing technical and business requirements for credit transfers and direct debits in Euro) that will be retained on Brexit. The purpose of the amendments is to ensure the SEPA Regulation can continue to operate effectively after Brexit and to maximize the likelihood of the U.K. remaining a member of SEPA as a third country. The Regulations provide HM Treasury with the power to revoke the retained SEPA Regulation, along with any other relevant associated legislation, in the event that the U.K. is no longer able to remain a member of the SEPA.

The Credit Transfers and Direct Debits in Euro (Amendment) (EU Exit) Regulations 2018 (SI 2018/1199) are available at: http://www.legislation.gov.uk/uksi/2018/1199/pdfs/uksi_20181199_en.pdf and the explanatory memorandum is available at: http://www.legislation.gov.uk/uksi/2018/1199/pdfs/uksiem_20181199_en.pdf.

UK Legislation Published to Onshore the European Long-Term Investment Funds Regulation for Brexit

On November 19, 2018, HM Treasury published a draft version of the Long-term Investment Funds (Amendment) (EU Exit) Regulations 2018. The draft Regulations correct deficiencies in the directly applicable European Long-term Investment Funds) Regulation to be retained on Brexit, which governs funds that invest into infrastructure and other long-term projects. The draft Regulations will primarily affect fund managers operating ELTIFs registered in the U.K.

The draft Regulations will create a U.K.-specific regime, which will enable eligible funds to obtain "Long-term Investment Fund" designations. U.K. managers of ELTIFs already authorized or registered with the U.K. FCA would be automatically included in the U.K. regime. HM Treasury has published similar onshoring legislation for the European Venture Capital Funds Regulation, which governs funds that invest into small and medium-sized enterprises, and the European Social Entrepreneurship Funds Regulation, which governs funds that invest into social investments. U.K.-specific regimes for these funds will also be created, allowing designation as a Social Entrepreneurship Fund or Registered Venture Capital Fund.

HM Treasury intends to lay the draft Regulations before Parliament before exit day.

The draft Regulations are available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/757164/Long-term_Investment_Funds_SI_Draft_Text.pdf, the explanatory information is available at: https://www.gov.uk/government/publications/draft-eu-exit-sis-for-investment-funds-and-their-managers/venture-capital-funds-amendment-eu-exit-regulations-2018-social-entrepreneurship-funds-amendment-eu-exit-regulations-2018-and-long-term-inve and details of the proposals for U.K. regimes for Social Entrepreneurship Funds and Registered Venture Capital Funds are available at: https://finreg.shearman.com/uk-legislation-published-to-onshore-the-eu-ventur.

Derivatives

US Commodity Futures Trading Commission Adopts Permanent $8 Billion Swap Dealer De Minimis Registration Threshold

On November 5, 2018, the Commodity Futures Trading Commission unanimously voted to adopt a final rule that would permanently set the swap dealer *de minimis* registration threshold at $8 billion. Absent further action by the CFTC, the *de minimis* threshold was previously scheduled to drop to $3 billion on December 31, 2019.

Under the final rule, as under current requirements, firms with swap dealing activity below the aggregate gross notional amount (AGNA) threshold of $8 billion over the previous 12 months would be exempt from the CFTC's swap dealer registration requirements. The CFTC said its analysis concluded that the $8 billion threshold subjects approximately 98% of swap transactions to swap dealer regulations. In the CFTC's determination, a $3 billion threshold would only subject a small number of additional swap transactions to such regulation, but would likely decrease swap market liquidity.

The CFTC had also previously proposed several other measures for the *de minimis* threshold, such as excluding swaps of insured depository institutions made in connection with loans from a firm's AGNA calculation. Although the CFTC did not adopt any of these additional proposals in the final rule, CFTC Chairman J. Christopher Giancarlo said he will direct CFTC staff to continue their analysis of these measures and other issues raised in comments on the rule.

The final rule is available at: https://www.cftc.gov/sites/default/files/2018-11/federalregister110518.pdf, the CFTC's fact sheet on the final rule is available at: https://www.cftc.gov/sites/default/files/2018-11/AdoptingRelease_factsheet110518.pdf, the CFTC Chairman Giancarlo's statement is available at: https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement110518 and CFTC Commissioner Dan Berkovitz's statement is available at: https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement110518.

US Securities and Exchange Commission Issues Non-Enforcement Position Regarding Security-Based Swap Business Conduct Rules

On October 31, 2018, the Securities and Exchange Commission issued a non-enforcement position providing market participants, for a five-year period, with alternative means of compliance with certain business conduct standards for security-based swap dealers and major security-based swap participants (SBS Entities).

Although the SEC has adopted a set of business conduct standards for SBS Entities, compliance with those rules is not yet required, pending finalization of certain other rules and implementation of registration of SBS Entities. The SEC issued the statement, in advance of implementation, to address market participants' concerns regarding compliance difficulties presented by differences between the SEC's business conduct standards and those of the CFTC, which are applicable to swap transactions with swap dealers.

The statement generally addresses four categories of requirements within its security-based swap dealer business conduct rules, including:

I. The mechanism by which an SBS Entity may determine that a non-ERISA employee benefit plan is not a "special entity," which would entitle the entity to heightened protections;

II. Reliance on certain written representations regarding recommendations provided by a security-based swap dealer, such that the security-based swap dealer can establish that it is not acting as an advisor;

III. Reliance on certain written representations from qualified independent representatives for purposes of satisfying the safe harbor requirements for SBS Entities acting as counterparties to special entities under Rule 15Fh-5(b); and

IV. Reliance on previously obtained written representations from a counterparty or representative relating to swaps for purposes of complying with security-based swap due diligence requirements, on the condition that the security-based swap dealer is not aware of information that would cause a reasonable person to question the accuracy of such representations.

The non-enforcement position will apply for five years following the compliance date for the SEC's forthcoming security-based swap dealer and major security-based swap participant registration rules.

The statement can be viewed at: https://www.sec.gov/rules/policy/2018/34-84511.pdf and the SEC's press release can be viewed at: https://www.sec.gov/news/press-release/2018-249.

Final Report on Incentives to Clear OTC Derivatives Published by Global Standard Setting Bodies

On November 19, 2018, a final joint report on the incentives to clear OTC derivatives was published by the Financial Stability Board, the International Organization of Securities Commissions, the Basel Committee on Banking Supervision and the Committee on Payments and Market Infrastructures. The report is part of the FSB's post-implementation evaluation of the effects of the G20 financial regulatory reforms.

The report sets out the results of an evaluation of the reforms that have been implemented to incentivize central clearing of OTC derivatives and outlines areas for further consideration by the global standard setting bodies. The reforms considered include mandatory clearing requirements, capital, liquidity and margin requirements, as well as the reforms to CCP resilience, recovery and resolution.

The evaluation found that:

I. the changes observed in OTC derivatives markets are consistent with the G20 Leaders' objective of promoting central clearing as part of mitigating systemic risk and making derivatives markets safer;

II. the relevant post-crisis reforms, in particular the capital, margin and clearing reforms, taken together, appear to create an overall incentive, at least for dealers and larger and more active clients, to centrally clear OTC derivatives;

III. non-regulatory factors, such as market liquidity, counterparty credit risk management and netting efficiencies, are also important and can interact with regulatory factors to affect incentives to centrally clear;

IV. some categories of clients have less strong incentives to use central clearing, and may have a lower degree of access to central clearing;

V. the provision of client clearing services is concentrated in a relatively small number of bank-affiliated clearing firms; and

VI. some aspects of regulatory reform may not incentivize provision of client clearing services.

The following areas for further consideration are highlighted in the report:

1. The impact of the reforms on smaller non-systemically important market participants.
2. The interaction between initial margin and the leverage ratio, which lead to a disincentive for client clearing service providers to offer or expand client clearing because:
   (i) IM does not reduce the leverage ratio's exposure measure for derivatives; and
   (ii) client IM held on a firm's balance sheet may increase the leverage ratio's exposure measure, even where margin must be segregated and there are restrictions on its use by the firm as a source of leverage.

   The Basel Committee is consulting on targeted revision of the leverage ratio exposure measure, proposing two possible options: (i) a treatment that would allow amounts of cash and non-cash IM received from a client to offset the potential future exposure of derivatives centrally cleared on the client's behalf; and (ii) a treatment that would align the treatment of client-cleared derivatives with the measurement as determined per the standardized approach to measuring counterparty credit risk exposures for risk-based capital requirements. The consultation closes on January 16, 2019.
3. The economics of client clearing and the relevant standards and their interaction with non-regulatory factors, including further quantitative analysis of the fixed costs associated with client clearing

businesses, the structure of clearing fees, the allocation practices of firms and the interaction of the relevant factors.

The report states that each standard setting body is responsible for deciding whether and how to amend a particular standard.

The report is available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD616.pdf, details of the consultation paper are available at: https://finreg.shearman.com/global-bodies-consult-on-incentives-to-centrally- and details of the Basel Committee consultation on leverage ratio are available at: https://finreg.shearman.com/Basel-Committee-on-Banking-Supervision-Consults--o.

FinTech

First EU Blockchain Industry Roundtable

On November 21, 2018, the European Commission published a press release on the outcome of the first EU Blockchain Industry Roundtable, which took place on November 20, 2018. The press release notes the establishment of the "International Association for Trusted Blockchain Applications" that will be open to any firm that wishes to contribute to the use of blockchain and distributed ledger technologies in the EU. This new Association will work with the European Commission and EEA states that are part of the European Blockchain Partnership to support interoperability, develop specifications and promote standards and regulatory convergence in this area.

The European Blockchain Partnership was established earlier this year and has been signed up to by Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the U.K.

The press release is available at: https://ec.europa.eu/digital-single-market/en/news/eu-blockchain-roundtable-supports-efforts-deploy-blockchain-technologies-eu and details of the European Blockchain Partnership are available at: https://ec.europa.eu/digital-single-market/en/news/european-countries-join-blockchain-partnership.

Recovery & Resolution

Bank of England Guidance to Firms on Valuation Capabilities to Support Resolvability

On November 19, 2018, the Bank of England published the "Dear CFO" letter sent by its Resolution Directorate to the Chief Financial Officers of relevant entities in financial groups within the remit of the BoE's principles-based "Statement of Policy on Valuation Capabilities to Support Resolvability." The SoP was published in June 2018 and sets out the BoE's expectations on the minimum standard of valuation capabilities that firms should have in place to ensure that their valuations are sufficiently timely and robust to support the effective resolution of the firm. Firms within the remit of the SoP will need to ensure that suitable capabilities are in place by January 1, 2021.

In the Dear CFO letter, the BoE sets out supporting and purely illustrative guidance on the requirements of the SoP. The guidance is split into two parts, covering valuations in the context of resolution and firm capabilities on a business-as-usual basis. It is intended to inform firms of the factors that the BoE anticipates

that an independent valuer would consider when undertaking resolution valuations, but does not prescribe how those valuations should be undertaken.

The BoE has also asked recipients of the Dear CFO letter to complete a survey on how they intend to implement the requirements of the SoP, to assist it with its future engagement with firms on their valuation capabilities.

The Dear CFO Letter is available at: https://www.bankofengland.co.uk/-/media/boe/files/letter/2018/guidance-on-valuation-capabilities-to-support-resolvability.pdf?la=en&hash=E5CAFB585B4321477D77AA6109F2F7C614870E30 and details of the Statement of Policy on Valuation Capabilities are available at: https://finreg.shearman.com/bank-of-england-confirms-approach-to-valuation-ca.

Upcoming Events

December 18, 2018: ESAs public hearing on draft joint guidelines on the cooperation and information exchange between national regulators supervising banks and other financial institutions for AML/CFT compliance

Upcoming Consultation Deadlines

December 4, 2018: FDIC request for comment on improving communication, transparency and accountability

December 6, 2018: ESA consultation on proposed amendments to the PRIIPs KID RTS

December 6, 2018: PRA consultation on updates to Statement of Policy, “The PRA’s approach to the systemic risk buffer”

December 7, 2018: FCA first consultation on Brexit-Related Handbook Changes and BTS

December 7, 2018: FCA consultation on the temporary permissions regime for EEA firms and investment funds

December 12, 2018: PRA consultation on revisions to supervisory reporting requirements

December 14, 2018: FRB request for comment with respect to facilitating faster payment systems

December 17, 2018: PSR consultation on Brexit-related changes to onshore RTS under the IFR

December 21, 2018: FCA second consultation on Brexit-related changes to its Handbook and BTS

January 2, 2019: BoE/PRA joint consultation on approach to amending financial services legislation for Brexit

January 2, 2019: PRA consultation on changes to PRA Rulebook and onshored BTS for Brexit

January 2, 2019: BoE consultation on changes to FMI rules and onshored BTS for Brexit

January 2, 2019: BoE consultation on approach to resolution statements of policy and onshored BTS for Brexit

January 11, 2019: ESMA call for evidence on periodic auctions for equity instruments

January 15, 2019: FCA consultation on climate change and green finance

January 16, 2019: Basel Committee consultation on leverage ratio treatment of client-cleared derivatives

January 25, 2019: FCA consultation on open-ended funds and illiquid assets

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

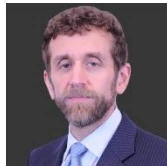
RUSSELL SACKS
Partner
New York
rsacks@shearman.com

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

TOBIA CROFF
Partner
Milan
tobia.croff@shearman.com

HERVÉ LETRÉGUILLY
Partner
Paris
hletreguilly@shearman.com

MATTHEW READINGS
Partner
London
matthew.readings@shearman.com

SIMON DODDS
Of Counsel
London
simon.dodds@shearman.com

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

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

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

KOLJA STEHL
Counsel
Frankfurt/London
kolja.stehl@shearman.com

ELIAS ALLAHYARI
Associate
London
elias.allahyari@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

OLIVER LINCH
Associate
London
oliver.linch@shearman.com

JENNIFER OOSTERBAAN
Associate
New York
jennifer.oosterbaan@shearman.com

WILF ODGERS
Associate
London
wilf.odgers@shearman.com

INYOUNG SONG
Associate
London
inyoung.song@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 • RIYADH* • SHANGHAI • SINGAPORE • TOKYO • TORONTO • WASHINGTON, DC

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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