

# 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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## AML/CTF, Sanctions and Insider Trading

### **Financial Action Task Force Consults on Draft Risk-Based Approach Guidance for the Securities Sector**

On July 6, 2018, the Financial Action Task Force published for consultation draft Risk-Based Approach Guidance for the securities sector. The FATF is developing the Guidance to assist countries, regulators, Financial Intelligence Units and participants in the securities sector to adopt a risk-based approach to anti-money laundering and countering financing of terrorism. The draft Guidance aims to assist in the risk-based design and implementation of applicable AML/CTF measures by providing general guidelines and examples of current practices and facilitate the effective implementation and supervision of national AML/CTF measures by focusing on risks and on mitigation measures. The FATF is also hoping that the draft Guidance will aid the development of a common understanding of what the risk-based approach to AML/CTF entails in the context of the securities sector. The Guidance will not be binding once it is finalized. The draft Guidance should be read in conjunction with the International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation and the 2009 Report on Money Laundering and Terrorist Financing.

The draft Guidance sets out the key principles involved in applying a risk-based approach to AML and CTF. There are separate sections providing specific guidance to securities providers and intermediaries and to securities supervisors on the effective implementation of a risk-based approach. The annexes provide examples of supervisory practices that have been adopted and examples of suspicious activity indicators in relation to securities.

The FATF is seeking feedback on the draft Guidance. In particular, the FATF would like to know if the guidance provides sufficient clarity and whether any additional guidance could be incorporated. The FATF would also welcome further examples of adopted supervisory practices and examples of suspicious activity indicators.

Responses to the consultation should be provided by August 17, 2018, including by providing a red line of the draft Guidance. The FATF intend to adopt the final Guidance at its October 2018 plenary meeting.

The consultation page is available at: [http://www.fatf-gafi.org/publications/fatfgeneral/documents/public-consultation-guidance-securities.html?\\_sm\\_au\\_=iVVJMfRLJFJFTR7](http://www.fatf-gafi.org/publications/fatfgeneral/documents/public-consultation-guidance-securities.html?_sm_au_=iVVJMfRLJFJFTR7).

## Bank Prudential Regulation & Regulatory Capital

### **US Federal Financial Regulators Release Statements Regarding Implementation and Impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act**

On July 5 and 6, 2018, the U.S. Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation released statements regarding the implementation and impact of the passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act. The agencies released a joint statement on July 6, 2018, which discusses rules that are jointly administered by the agencies and immediately affected by the EGRRCPA. These include regulations, such as company-run stress testing, resolution plans, the Volcker Rule, high volatility commercial real estate exposures, examination cycles, municipal obligations as high-quality liquid assets and appraisals for certain rural transactions. Certain changes to these rules and regulations are immediately effective, while other changes will require further rulemaking from the agencies. The statement also explains that while certain formal requirements are being relaxed under the EGRRCPA, the agencies will continue to supervise the banks under their jurisdiction and will, for example, continue to review the risk management and capital planning practices of these institutions through the regular supervisory process.

On July 6, 2018, the Federal Reserve Board released a separate statement on certain Federal Reserve Board-specific rules and regulations affected by the EGRRCPA. In addition to further guidance regarding high volatility commercial real estate exposures, the Federal Reserve Board statement discusses changes to assessments, enhanced prudential standards and other requirements, such as certain reporting, disclosure and recordkeeping requirements. Regarding assessments, the Federal Reserve Board noted that while it will collect assessments from bank holding companies and savings and loan holding companies with \$50 billion or more in total consolidated assets for the year 2017, it will not collect assessments from bank holding companies and savings and loan holding companies with less than \$100 billion in total consolidated assets going forward. With respect to enhanced prudential standards, the Federal Reserve Board noted that it will not take any action to require bank holding companies with less than \$100 billion in total consolidated assets to comply with certain existing regulatory requirements, including the enhanced prudential standards under Regulation YY, the liquidity coverage ratio requirements under Regulation WW and the capital planning requirements under Regulation Y. A detailed list of affected regulatory requirements is provided as an attachment to the Federal Reserve Board statement.

On July 5, 2018, the OCC and FDIC each released statements with respect to the EGRRCPA's effect on the Home Mortgage Disclosure Act. These statements noted that the EGRRCPA provides two separate partial exemptions from HMDA reporting requirements, which are generally available for certain financial institutions that originated fewer than 500 closed-end mortgage loans or those that originated fewer than 500 open-end lines of credit in each of the two preceding calendar years. With respect to these transactions, financial institutions that qualify for a partial exemption are exempt from the collection, recording and reporting requirements for certain data points specified in Regulation C. The statements also provide guidance with respect to the submission and formatting of Loan/Application Registers, and note that the U.S. Consumer Financial Protection Bureau will be issuing guidance later this summer regarding the applicability of the EGRRCPA to HMDA data collected in 2018.

The Joint agency statement is available at: <https://www.occ.treas.gov/news-issuances/news-releases/2018/nr-ia-2018-69a.pdf>; the OCC statement regarding the HMDA is available at: <https://www.occ.treas.gov/news-issuances/bulletins/2018/bulletin-2018-19.html>, the FDIC statement on the HMDA is available at: <https://www.fdic.gov/news/news/financial/2018/fil18036a.pdf> and the Federal Reserve Board statement is available at: <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf>.

### **EU Technical Standards Published on Assessment Methodology for Use of Advanced Measurement Approaches for Calculating Operational Risk Capital Requirements**

On July 6, 2018, a Commission Delegated Regulation was published in the Official Journal of the European Union, which supplements the Capital Requirements Regulation with Regulatory Technical Standards on the assessment methodology to be used by national regulators when deciding whether to permit institutions to use Advanced Measurement Approaches for operational risk. The RTS cover: (i) the qualitative and quantitative criteria that firms must meet before they are granted permission to use AMA models for calculating their capital requirements to cover operational risk; (ii) the criteria for the supervisory assessment of key methodological components of the operational risk measurement system; and (iii) common standards for the supervisory assessment of a bank's operational risk governance.

The Delegated Regulation was made by the European Commission on March 14, 2018 and is based on final draft RTS submitted to the European Commission by the European Banking Authority in June 2015. The Delegated Regulation comes into effect across the EU on July 26, 2018. For institutions currently using AMA

models or whose application to do so is pending, the Delegated Regulation will apply from July 26, 2019 and certain provisions related to correlation will not apply until July 26, 2020.

The Commission Delegated Regulation (EU) 2018/959 is available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0959&from=EN>.

### **European Central Bank Consults on Materiality Threshold for Credit Obligations Past Due**

On July 3, 2018, the European Central Bank launched a consultation on a proposed Regulation on the materiality threshold for credit obligations past due under the CRR. The CRR risk quantification provisions set out that a default occurs when an obligor is past due more than 90 days on any material credit obligation to a firm, its parent or any of its subsidiaries. The materiality of the credit obligation is to be assessed against a threshold set by the national regulator according to its view of a reasonable level of risk. The ECB is responsible for direct prudential supervision of certain significant banks based in the Eurozone as part of the Single Supervisory Mechanism and must set the materiality threshold for these banks. The ECB must take into account the RTS on the materiality threshold for credit obligations past due that supplement the CRR requirements on the conditions for use of the internal ratings-based approach.

The ECB is proposing a single materiality threshold for all Eurozone significant institutions for retail and for non-retail exposures, regardless of the method used for the calculation of capital requirements.

The consultation closes on August 17, 2018. The ECB will consider the feedback it receives when finalizing the Regulation. The final Regulation will take effect from December 31, 2020.

The draft Regulation is available at:

[https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/materiality\\_threshold/ssm.materiality\\_threshold\\_draft.en.pdf?79deb23bcf8733dc92d8ef0cdd278e6e](https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/materiality_threshold/ssm.materiality_threshold_draft.en.pdf?79deb23bcf8733dc92d8ef0cdd278e6e), the FAQs are available at:

[https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/materiality\\_threshold\\_faq.en.html](https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/materiality_threshold_faq.en.html) and the costs and benefits analysis are available at:

[https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/materiality\\_threshold/ssm.materiality\\_threshold\\_cb\\_analysis.en.pdf](https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/materiality_threshold/ssm.materiality_threshold_cb_analysis.en.pdf).

### **UK Financial Policy Committee Outlines Steps to Reduce Risks to the UK's Financial Stability**

On July 3, 2018, the Bank of England published a Financial Stability Report, dated June 2018, and a record of the Financial Policy Committee Meeting held on June 19, 2018. The Report sets out the FPC's view of the U.K.'s financial stability, the resilience of the U.K.'s financial system and the risks posed to each of those. Where applicable, the Report also notes the steps that the FPC is taking to address the risks. The record of the meeting provides a summary of issues discussed by the FPC in June.

The Report states that the 2017 stress test showed that the U.K. banking system is resilient to severe domestic, global and market shocks, including any disorderly exit from the EU. The FPC does not consider that additional capital buffers are necessary at this stage. It is also maintaining the U.K. countercyclical capital buffer (CCyB) rate at 1%. The FPC will conduct a comprehensive assessment of the resilience of the U.K. banking system in the 2018 stress test and review the adequacy of the 1% CCyB rate. The FPC will continue to monitor the potential effects arising from Brexit and notes that its main concern remains the continuity of existing derivatives contracts.

The FPC is also working on building on the financial system's resilience to cyber-attacks by setting standards on how quickly firms must be able to restore vital services after an attack. The BoE will work with the National Cyber Security Centre to stress test firms' ability to meet the FPC's standards.

The FPC also notes the potential risks to financial stability arising from continued reliance on LIBOR and will monitor progress on establishing alternatives.

The FPC's next policy meeting is on October 3, 2018 and the record of that meeting will be published on October 17, 2018.

The Financial Stability Report is available at: <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2018/june-2018.pdf> and the record of the FPC meeting is available at:

<https://www.bankofengland.co.uk/-/media/boe/files/record/2018/financial-policy-committee-meeting-june-2018.pdf>.

### **UK Prudential Regulator Consults on Reflecting the Systemic Risk Buffer Framework Within the Leverage Ratio Framework for UK Systemic Ring-Fenced Bodies**

On July 3, 2018, the U.K. Prudential Regulation Authority published a consultation paper entitled "UK leverage ratio: Applying the framework to systemic ring-fenced bodies and reflecting the systemic risk buffer."

The Systemic Risk Buffer is one of the elements of the overall capital framework for U.K. banks and building societies. It is applied by the PRA to individual institutions and will be introduced at the same time that ring-fencing comes into force in 2019. SRB institutions are banks falling within the definition of Ring-fenced Bodies in the Financial Services and Markets Act 2000 and large building societies that hold more than £25 billion in deposits (where one or more of the accountholders is a small business) and shares (excluding deferred shares).

The BoE's FPC issued a Policy Statement in 2015 which provided that domestic systemically important banks would be subject to a leverage ratio buffer that complements their risk-weighted capital requirements from 2019.

The FPC finalized the framework for the SRB in 2016. On publishing the SRB framework, the FPC announced that it "anticipates that the leverage ratio will be applied to U.K. G-SIBs and other major U.K. banks and building societies at the level of the RFB subgroup from 2019 (where applicable), as well as on a consolidated basis." The PRA must amend the U.K. leverage ratio framework to reflect the SRB framework in line with the FPC's intention.

The PRA's consultation is relevant to firms in scope of the U.K. leverage ratio framework that are also SRB institutions, or part of a group containing an SRB institution. The consultation paper seeks feedback on the PRA's proposals to:

- apply the U.K. leverage ratio framework on a sub-consolidated basis to RFBs in scope;
- amend the Additional Leverage Ratio Buffer to reflect the SRB; and
- where applicable, expect firms to hold capital on a group consolidated basis to address RFB group risk (this is known as the Leverage Ratio Group Add-on).

The proposals will require the PRA to update the Leverage Ratio, Public Disclosure, Reporting Leverage Ratio, and Ring-fenced Bodies Parts of the PRA Rulebook. It will also need to update its supervisory statements "The UK leverage ratio framework" and "UK leverage ratio: instructions for completing data items FSA083 and FSA084." An update will also be required to the FSA083 Leverage Ratio Reporting template and instructions.

In its financial stability report of June 2018, the FPC announced that it intends to carry out a comprehensive review of the leverage ratio framework in light of revised international standards, including Basel III and proposed revisions to the CRR. The proposals in the PRA consultation may be revisited at a later date depending on the outcome of that review.

Comments on the consultation are invited by September 25, 2018.

The consultation paper (PRA CP 14/18) is available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2018/cp1418.pdf>.

### **Basel Committee Finalizes Revised Assessment Framework for G-SIBs**

On July 5, 2018, the Basel Committee on Banking Supervision published a revised methodology and the higher loss absorbency (HLA) requirement for the assessment of Global Systemically Important Banks. The revised framework updates and replaces the Basel Committee's July 2013 publication, "Global systemically important banks: updated assessment methodology and the higher loss absorbency requirement."

The Basel Committee committed, on the introduction of the G-SIB framework, to review the framework every three years. It consulted on potential enhancements to the framework between March and June 2017. Following feedback to that consultation, the Basel Committee is proposing no changes to the fundamental structure of the G-SIB framework and states that it is generally recognized that the G-SIB framework is meeting its primary objective of requiring systemically important banks to hold higher capital buffers. The framework is also providing incentives for G-SIBs to reduce their systemic importance.

The proposed revisions to enhance the framework include a timetable for implementation. The revised assessment methodology will apply from 2021, based on end-2020 data. The corresponding HLA requirements based on the revised methodology will apply from January 1, 2023.

The Committee has made the following revisions:

- the definition of cross-jurisdictional indicators has been amended;
- a trading volume indicator has been introduced;
- the weights in the substitutability category have been modified;
- the scope of consolidation to insurance subsidiaries has been extended;
- the disclosure requirements have been revised;
- the framework incorporates further guidance on bucket migration and associated HLA surcharge when a G-SIB moves to a lower bucket; and
- a transitional schedule has been set for the implementation of the enhancements to the G-SIB framework.

The Basel Committee remains committed to the three-year review cycle and will complete the next review of the G-SIB framework by 2021. The Committee proposes to pay particular attention in the next review to the consideration of possible alternative methodologies for the substitutability category, with a view to enabling the cap to be removed at that time.

The revised assessment framework is available at: <https://www.bis.org/bcbs/publ/d445.pdf> and details of the March 2017 consultation are available at: <https://finreg.shearman.com/revised-assessment-framework-for-g-sibs-proposed>.

## Bank Structural Reform

### European Commission Formally Withdraws Proposals for an EU Regulation on Bank Structural Reform

On July 3, 2018, following its announcement in its 2018 Work Programme of its intention to withdraw 15 pending EU legislative proposals, the European Commission announced the formal withdrawal of that legislation, which includes the 2014 Proposal for a Regulation on structural reform of the EU banking sector.

The original proposal built on the 2013 recommendations of a high level expert group on reforming the structure of EU banking sector, chaired by Bank of Finland Governor and ECB Governing Council member Erkki Liikanen. For banks within its scope, the provisions of the proposed regulation would have imposed a ban on proprietary trading and would have empowered supervisors to require banks to ring-fence certain trading activities from a deposit-taking entity.

The rationale given for withdrawal of the proposed regulation is that no agreement on the proposal was foreseeable, the proposal having made no progress since 2015. In the meantime, the financial stability objective of the proposed regulation has been met by other regulatory measures in the banking sector, notably the entry into force of the Banking Union's supervisory and resolution arms. Under the Bank Recovery and Resolution Directive, for example, resolution authorities can require banks to make structural changes preemptively if that is needed to make them resolvable.

The Commission press release is available at: <http://europa.eu/rapid/midday-express-03-07-2018.htm?locale=en#3> and the rationale for withdrawal is available at: [https://ec.europa.eu/info/sites/info/files/cwp\\_2018\\_annex\\_iv\\_en.pdf](https://ec.europa.eu/info/sites/info/files/cwp_2018_annex_iv_en.pdf).

## Brexit for Financial Services

### First UK Statutory Instrument Made Under the European Union (Withdrawal Act) 2018

On July 3, 2018, the European Union (Withdrawal) Act 2018 (Commencement and Transitional Provisions) Regulations 2018 were made. These Regulations are the first statutory instrument to be made under the EU (Withdrawal) Act 2018, which was made on June 26, 2018. The Regulations bring into force some of the provisions of the Act. The Act, which was also formerly referred to as the Great Repeal Bill, ensures that the U.K.'s laws will continue to operate from the day the U.K. exits the EU.

The Regulations are available at: [http://www.legislation.gov.uk/ukSI/2018/808/pdfs/ukSI\\_20180808\\_en.pdf?\\_sm\\_au\\_=iVV6W4V0DS4MFrRB](http://www.legislation.gov.uk/ukSI/2018/808/pdfs/ukSI_20180808_en.pdf?_sm_au_=iVV6W4V0DS4MFrRB) and details of the EU (Withdrawal) Act 2018 are available at: <https://finreg.shearman.com/uk-brexit-legislation-receives-royal-assent>.



## Competition

### **UK Competition and Markets Authority to Impose Confidentiality Ring for Provisional Decision Report on the Investment Consultants Market Investigation**

On July 2, 2018, the U.K. Competition and Markets Authority published a notice of intention to operate a confidentiality ring, following publication of the Provisional Decision Report on the Investment Consultants Market Investigation. The CMA is assessing the supply and acquisition of investment consultancy services and fiduciary management services. As part of the investigation, the CMA has received information and/or data from a number of parties. This data has been used by the CMA in the investigation, in particular in preparing the Provisional Decision Report, which will be published in mid-July 2018. The notice:

- provides a description of the data that has been used;
- sets the timing of the confidentiality ring—from 9.30 am on the date of publication of the Provisional Decision Report until 5 pm on the date five weeks thereafter; and
- stipulates the access conditions under the confidentiality ring, including completion of an undertaking by those wishing to access the confidentiality ring, the form of which is set out in an annex.

The CMA's notice is available at:

[https://assets.publishing.service.gov.uk/media/5b3a2bbbe5274a6ff7d9055e/final\\_notice\\_of\\_intention\\_confidentiality\\_ring.pdf](https://assets.publishing.service.gov.uk/media/5b3a2bbbe5274a6ff7d9055e/final_notice_of_intention_confidentiality_ring.pdf) and the form of undertaking is available at:

[https://assets.publishing.service.gov.uk/media/5b3a2bd5e5274a6ff156b583/final\\_confidentiality\\_ring\\_undertakings.pdf](https://assets.publishing.service.gov.uk/media/5b3a2bd5e5274a6ff156b583/final_confidentiality_ring_undertakings.pdf).

## Conduct & Culture

### **UK Conduct Regulator Issues Near-Final Rules on Extension of Individual Accountability Regime to All Financial Services Firms**

On July 4, 2018, the U.K. Financial Conduct Authority published Policy Statements confirming the rule changes it will apply to extend the application of the Senior Managers & Certification Regimes to all FCA solo-regulated firms (that is, firms for which the FCA is both conduct and prudential regulator). At this stage, the rules are near-final as they are subject to commencement regulations that will be made by HM Treasury and they may also be amended by subsequent changes related to, for example, Brexit or SM&CR optimizations. The FCA also plans to consult separately on rules for benchmark-related activities.

The extended SM&CR will apply to all firms authorized under the Financial Services and Markets Act 2000 and regulated by the FCA, as well as EEA and third country (non-EEA) branches. SM&CR will be extended to FCA solo-regulated firms from December 9, 2019, including insurance intermediaries.

The SM&CR was introduced in 2016 to strengthen individual accountability in the U.K. banking sector. The SM&CR currently applies to U.K. banks, building societies, credit unions, PRA-designated investment firms and branches of EEA banks and third-country banks operating in the U.K. HM Treasury issued a policy paper in October 2015 announcing the intention to reform and extend the SM&CR to all sectors of the U.K. financial services industry. The U.K. Parliament legislated in May 2016 to extend the SM&CR to all firms authorized under FSMA, replacing the existing Approved Persons Regime.

#### The FCA's July and December 2017 consultations

In July 2017, the FCA published a consultation entitled "Individual accountability: extending the SM&CR to all FCA firms." The consultation closed on November 3, 2017. In December 2017, the FCA set out proposals for

applying the regime to employees of the firms that would be brought into the SM&CR, in a consultation entitled “Individual accountability: transitioning FCA firms and individuals to the SM&CR” and a consultation entitled “The duty of responsibility for insurers and FCA solo-regulated firms.” Those consultations closed on February 21, 2018.

#### Extending the SM&CR to all FSMA-authorized firms

In its July 2017 consultation, the FCA had proposed rules designed to accommodate the wide variety of FCA-authorized firm types. The FCA proposed implementing:

- a “core regime” consisting of a standard set of requirements that will apply to all FCA solo-regulated firms;
- an “enhanced regime” which will apply extra requirements to the very small number of solo-regulated firms whose size, complexity and potential impact on consumers warrant more attention; and
- a reduced set of requirements which will apply to firms the FCA has categorized as “limited scope” firms.

The FCA proposed that the core regime, the enhanced regime and the regime for limited scope firms would all contain tailored versions of the individual components of SM&CR that currently applies to banks, namely:

- the Senior Managers Regime, comprising FCA pre-approval of senior managers, statements of responsibility and a duty of responsibility that will hold senior managers accountable for failures to take “reasonable steps” to avoid a breach;
- the Certification Regime, which will require employers to conduct at least annual fitness and propriety assessments of employees that are captured by the regime; and
- Conduct Rules, which consist of high level standards to be complied with by almost all employees.

In Part 1 of its Policy Statement, the FCA explains that respondents to that consultation largely supported the proposed approach but that there were some suggestions for changes to the proposed rules and requests for clarification. The FCA will therefore be implementing its proposals largely as consulted on, subject to the following changes:

- The rules relating to core firms included a prescribed responsibility to inform the governing body of their legal and regulatory obligations. Following feedback, this has been deleted;
- The rules now set out a process for firms use to inform the FCA that they wish to apply voluntarily a higher regime tier;
- The FCA has amended three of the enhanced criteria to smooth single year anomalies; and
- The FCA has extended by six months (to 12 months) the time period for a firm meeting relevant criteria to implement the requirements for enhanced tier.

#### Transitioning FCA firms and individuals to the SM&CR

The FCA consulted in December 2017 on proposals for transitioning FCA solo-regulated firms and their staff to SM&CR. The FCA proposed a so-called “conversion process.” For firms falling within the “core” regime and “limited scope” firms, the FCA proposed that conversion would be automatic. The result of automatic conversion would be that pre-existing approvals under the current Approved Persons Regime would automatically be converted to Senior Management Functions. For larger and/or more complex firms in the “enhanced” regime, the FCA proposed that the conversion process would require submission of a conversion notification, a statement of responsibilities and a responsibilities map. The consultation paper contained a tool for firms to check whether they fell into the core, enhanced or limited scope categories.

In Part 2 of its Policy Statement, the FCA confirms that, following feedback, it proposes to implement the conversion process proposals largely as consulted on. However, it has made the following two changes: (i) the reporting period (REP008) for limited permission consumer credit firms will be aligned with their annual return; and (ii) a number of regulatory forms have been amended.

#### Duty of responsibility for FCA solo-regulated firms

The duty of responsibility is a component of the SM&CR that allows the FCA to take enforcement action against a Senior Manager where there has been a contravention of a relevant requirement by the Senior Manager's firm, in circumstances where the Senior Manager did not take such steps as a person in their position could reasonably have been expected to take to avoid the contravention occurring or continuing. The FCA updated its Decision Procedure and Penalties manual (DEPP) in May 2017 to set out guidance on how it enforces the duty of responsibility.

The FCA consulted in December 2017 on how it proposed to apply the duty of responsibility to senior managers of FCA solo-regulated firms. In that consultation, the FCA summarized some of the factors it took into account, in its earlier consultation in July 2017, when proposing only definitional changes and new guidance in its DEPP manual to reflect the extension of the duty to FCA solo-regulated firms. The FCA sought feedback on whether any further changes might be required. In its Policy Statement on guidance on the duty of responsibility, the FCA confirms that, following responses to that consultation, it remains of the view that no further amendments to DEPP or its other rules are necessary for implementing the duty of responsibility, other than the definitional amendments and guidance consulted on.

#### The transition process

The FCA has separately published a Guide for FCA solo-regulated firms that will move to the new regime from December 9, 2019. Among other things, the Guide explains how the SM&CR applies to different types of firm and sets out implementation timescales. The FCA will contact firms ahead of the conversion window with its indicative assessment of their status based on the information that it holds. Firms must assess for themselves which level of the regime applies to them and, to ensure that they are allocated within the correct tier, must inform the FCA if they believe the FCA's indicative assessment is wrong.

The rules include two transitional provisions to help firms move to the new regime:

- Firms must identify their Certification Staff at the start of the new regime, but have a further 12 months to complete the initial certification process.
- Senior Managers and Certification Staff will need to have been identified and trained and abide by the Conduct Rules from the start of the new regime, but firms will have 12 months to train their other staff on the Conduct Rules.

The FCA Policy Statement on extending the SM&CR to FCA solo-regulated firms (FCA PS 18/14) is available at: <https://www.fca.org.uk/publication/policy/ps18-14.pdf>, the FCA Policy Statement on guidance on the duty of responsibility for insurance and reinsurance firms regulated by the FCA, and FCA solo-regulated firms (FCA PS 18/16) is available at: <https://www.fca.org.uk/publication/policy/ps18-16.pdf>, the FCA's SM&CR guide for FCA solo-regulated firms is available at: <https://www.fca.org.uk/publication/policy/guide-for-fca-solo-regulated-firms.pdf>, the updated Cost Benefit Analysis is available at: <https://www.fca.org.uk/publication/research/cost-benefit-analysis.pdf>, our summary of the July 2017 consultations is available at: <https://finreg.shearman.com/financial-conduct-authority-consults-on-extending>, our summary of the December 2017 consultations are available at: <https://finreg.shearman.com/financial-conduct-authority-consults-on-extending> and the HM Treasury's 2015 Policy Paper on extension of SM&CR is

available at:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/468328/S\\_MCR\\_policy\\_paper\\_final\\_15102015.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/468328/S_MCR_policy_paper_final_15102015.pdf).

### **UK Regulators Finalize Rule Changes For Extending Individual Accountability Regime to Insurers**

On July 4, 2018, the U.K. FCA and PRA published Policy Statements confirming the near-final and final rule changes they will apply to extend the application of the SM&CR to insurers. The Policy Statements do not make any changes to the prudential rules implementing Solvency II or to the wider U.K. regulatory framework for insurers.

The extended SM&CR will apply from December 10, 2018, subject to commencement regulations being made by HM Treasury. The SM&CR will apply to all insurers and reinsurers regulated by the FCA and the PRA. The Policy Statements will be of specific interest to Solvency II firms (that is, all firms within the scope of the U.K. rules implementing the Solvency II Directive), insurance special purpose vehicles (undertakings with permission to carry on the regulated activity of insurance risk transformation), insurers outside the scope of the Solvency II Directive (so-called Non-Directive Firms) and small run-off firms (all insurers with less than £25 million technical provisions that no longer have permission to write or acquire new business).

The FCA and the PRA introduced the SM&CR in 2016 to apply new individual accountability obligations to U.K. banks, building societies, credit unions, PRA-designated investment firms and branches of EEA and non-EEA (third-country) banks operating in the U.K. An accountability regime for insurers was also introduced at the same time, by: (a) the PRA's Senior Insurance Managers Regime; and (b) amendments by the FCA to its Approved Persons Regime to implement the governance requirements of the Solvency II Directive. However, the accountability regime for insurers lacks certain key elements of the SM&CR and therefore the government has taken the decision to replace the existing regime for insurers with the full SM&CR.

#### The FCA's July and December 2017 consultations and Policy Statements

In July 2017, the FCA and PRA published consultations entitled "Individual accountability: extending the SM&CR to insurers." The consultation closed on November 3, 2017. In December 2017, the FCA also set out proposals for applying the regime to employees of the insurance firms that would be brought into the SM&CR, in a consultation entitled "Individual accountability: transitioning insurers and individuals to the SM&CR." That consultation closed on February 21, 2018.

In its Policy Statement, the FCA explains the changes to its rules that will apply the SM&CR to all insurers, replacing the Approved Persons Regime. The rule changes will also apply the Conduct Rules to most staff in insurers. Following supportive feedback to the proposals in its consultations, the FCA will implement the proposals as consulted on. The Policy Statement also sets out combined lists of FCA and PRA senior management functions and FCA and PRA prescribed responsibilities.

#### Duty of responsibility for insurance and reinsurance firms regulated by the FCA

The duty of responsibility is a component of the SM&CR that allows the FCA to take enforcement action against a Senior Manager where there has been a contravention of a relevant requirement by the Senior Manager's firm, in circumstances where the Senior Manager did not take such steps as a person in their position could reasonably have been expected to take to avoid the contravention occurring or continuing. The FCA updated its Decision Procedure and Penalties manual (DEPP) in May 2017 to set out guidance on how it enforces the duty of responsibility.

The FCA consulted in December 2017 on how it proposed to apply the duty of responsibility to senior managers of insurance and reinsurance firms. In that consultation, the FCA summarized some of the factors it

took into account, in its earlier consultation in July 2017, when proposing only definitional changes and new guidance in its DEPP manual to reflect the extension of the duty to insurance and reinsurance. The FCA sought feedback on whether any further changes might be required. In its Policy Statement, the FCA explains that, following responses to that consultation, it remains of the view that that no further amendments to DEPP or its other rules are necessary for implementing the duty of responsibility, other than the definitional amendments and guidance consulted on.

#### The PRA's consultations

In July 2017, the PRA published a consultation paper entitled "Strengthening individual accountability in insurance: extension of SM&CR", which set out its substantive proposals for extending the SM&CR to insurers. The consultation closed on November 3, 2017. The PRA consulted further in December 2017 in a consultation entitled "Strengthening accountability: implementing the extension of the SM&CR to insurers and other amendments." That consultation built on its July 2017 consultation and was also expected to be read in conjunction with the PRA's earlier consultations on optimizations to the Senior Insurance Managers Regime and changes to SMR forms.

The December 2017 consultation set out the PRA's proposals to simplify the requirements on firms, by streamlining the existing SM&CR and SIMR forms and amending Part 4A Permission forms to reduce the total number of forms from 26 to 11. The forms will no longer distinguish between firm types, so the same set of forms can be used by both banking firms and insurance firms. The PRA set out a proposed list of Senior Management Functions for the newly integrated regime and the process for individuals transferring from an SMF at an insurance firm to a banking firm. The PRA also took the opportunity in that consultation to make some changes to remove gendered language from the SM&CR.

The PRA's Policy Statement sets out feedback on the responses it received to its July and December 2017 consultations. The Policy Statement explains that respondents were broadly supportive of the proposals and therefore the PRA will be implementing its proposals largely as consulted on, subject to a minor change in the scope of application of the Certification Regime to small NDFs: This change will mean that, instead of the CR applying to all members of the governing body and all employees reporting directly to the governing body, the CR will instead apply only to members of the governing body other than PRA/FCA approved persons or non-executive directors.

The Policy Statement includes the final PRA instrument for amending the PRA rules to extend the SM&CR to insurers. The Policy Statement also includes (in appendices):

- An updated version of the PRA's supervisory statement on strengthening individual accountability in insurance (SS 35/15);
- A consolidated statement of policy on conditions, time limits and variations of approval; and
- A directory of the streamlined set of forms of the SM&CR and amendments to Part 4A FSMA permissions forms.

#### The transition process

The FCA has separately published a Guide for insurers on moving to the new regime from December 10, 2018, which among other things explains how the SM&CR applies to different type of insurer and sets out implementation timescales.

The rules include two transitional provisions to help firms move to the new regime:

- Firms must identify their Certification Staff ahead of December 10, 2018, but have a further 12 months to complete the initial certification process.

- Senior Managers and Certification Staff will need to have been identified and trained and abide by the Conduct Rules ahead of the start of the new regime, but firms will have 12 months to train their other staff on the Conduct Rules.

The FCA Policy Statement on extending the SM&CR to insurers (FCA PS 18/15) is available at:

<https://www.fca.org.uk/publication/policy/ps18-15.pdf>, the FCA Policy Statement on guidance on the duty of responsibility for insurance and reinsurance firms regulated by the FCA, and FCA solo-regulated firms (FCA PS 18/16) is available at: <https://www.fca.org.uk/publication/policy/ps18-16.pdf>, the PRA Policy Statement on extension of the SM&CR to insurers (PRA PS 15/18) is available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2018/ps1518.pdf>, the FCA's SM&CR guide for insurers is available at: <https://www.fca.org.uk/publication/policy/guide-for-insurers.pdf> and HM Treasury's announcement of the SM&CR start date for insurers is available at: <https://www.gov.uk/government/news/new-accountability-rules-for-insurers>.

A summary of the July 2017 consultations is available at: <https://finreg.shearman.com/financial-conduct-authority-consults-on-extending> and a summary of the December 2017 consultations is available at: <https://finreg.shearman.com/uk-regulators-consult-further-on-extension-of-ind>.

## Cyber Security

### Financial Stability Board Issues Consultation on Developing a Cyber Lexicon

On July 2, 2018, as part of its work on the protection of financial stability against the malicious use of information and communication technologies, the Financial Stability Board published a draft cyber lexicon for consultation.

In March 2017, the FSB was asked by the G20 Finance Ministers to review and produce a stock-take report on the existing regulation, supervisory practices and guidance on cyber security in the financial sectors of G20 jurisdictions. The G20 welcomed the FSB's stock-take report in October 2017 and asked the FSB to continue its work and to develop a common lexicon of cyber terms.

The FSB stresses that the lexicon is not intended for use in the legal interpretation of any international arrangement or agreement or any private contract. The use of the cyber lexicon will not be mandatory. Its purpose is to support the work of the FSB, standard-setting bodies, national authorities and private sector participants to address, and develop guidance on, cyber security and cyber resilience in the financial sector. In particular, the aim of the cyber lexicon is to create a cross-sector common understanding of relevant cyber security and cyber resilience terminology and to facilitate assessment and monitoring of financial stability risks in cyber risk scenarios.

The FSB established a Working Group of experts to develop the lexicon, chaired by the U.S. Federal Reserve Board and including representatives from member jurisdictions and from each of the standard-setting bodies. In selecting terms to be included in the lexicon, the Working Group applied criteria to reflect the scope and objective of the lexicon and to exclude technical ICT terms and general business and regulatory terms. Following the selection of terms, further criteria were used to develop the relevant definition. The FSB is now seeking feedback on the definitions it has developed, whether the criteria used for selection and definition of terms are appropriate, whether terms should be added, deleted or modified and on how the lexicon might be maintained and updated going forward.

Comments on the draft lexicon are invited by August 20, 2018. The FSB will publish all submissions on its website unless respondents expressly request otherwise.

The FSB intends to deliver the completed lexicon to G20 leaders at their summit in Buenos Aires on November 30 – December 1, 2018.

The consultation paper is available at: <http://www.fsb.org/wp-content/uploads/P020718.pdf>.

## Derivatives

### EU and UK Authorities Clarify Clearing Obligation Expectations for Pension Schemes

On July 3, 2018, the European Securities and Markets Authority published a statement on the transitional exemption from the clearing obligation for pension scheme arrangements under the European Market Infrastructure Regulation and delegated regulations. Transitional provisions provide for PSAs to be exempt from the clearing obligation until August 16, 2018. There is no provision in EMIR that would allow for a further extension of this exemption period. It is proposed that this exemption will be further extended under the proposal to amend EMIR, known as EMIR Refit. The length of the extension is yet to be agreed as part of the EMIR Refit legislative process between the European Parliament (which advocates a two-year extension) and the Council of the European Union (which supports a three-year extension). Parliament is also proposing to backdate the application of the new transitional period to August 16, 2018 if EMIR Refit enters into force after the expiry of the existing exemption so as to prevent a gap between the two exemptions periods, providing legal certainty for PSAs and their counterparties.

ESMA has recognized that the position may create uncertainty for derivatives counterparties. ESMA states that national regulators are expected not to prioritize “their supervisory actions towards entities that are expected to be exempted again in a relatively short period of time and to generally apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation in a proportionate manner.”

The U.K. FCA issued a statement on July 4, 2018 supporting ESMA’s statement. The FCA confirmed that it will not require PSAs and their counterparties to put processes in place to clear derivatives during the interim gap.

The ESMA’s statement is available at: <https://www.esma.europa.eu/press-news/esma-news/esma-issues-clarifications-clearing-obligation-pension-scheme-arrangements> and the FCA’s statement is available at: <https://www.fca.org.uk/markets/emir>.

## Financial Market Infrastructure

### UK Regulators Consult on Improving Operational Resilience

On July 5, 2018, the BoE, the PRA and the FCA published a joint discussion paper entitled “Building the UK financial sector’s operational resilience.” The Discussion Paper is aimed at opening a dialogue with the financial services industry on achieving what the Authorities view as a “step change” in the operational resilience of firms and Financial Market Infrastructures and at generating debate about the expectations regulators and the wider public might have of the operational resilience of financial services institutions.

While the existing regulatory framework already supports operational resilience, the BoE, PRA and FCA are together considering the extent to which they might supplement existing policies, to improve the resilience of the financial system as a whole and increase the focus on operational resilience within firms and FMIs.

In the discussion paper, the Authorities explain that operational disruptions can threaten the viability of affected firms, cause harm to consumers and market participants and cause instability in the financial system. Firms and FMIs must have the capabilities to prevent, respond to, recover from and learn from

operational disruptions such as cyber-attacks, failures in outsourced services or large scale technological changes. Poor operational resilience in firms can impact the interlinked objectives of the Authorities, with the consumer protection objective being likely to be affected more often (and by more firms) than the safety and soundness and financial stability objectives.

The Authorities consider that managing operational resilience is most effectively addressed by focusing on business services, rather than on the systems and processes that support those services. In the Authorities' view, firms and FMIs are more likely to be operationally resilient if, rather than focus on ensuring robust systems to avoid potential disruption, they work on the assumption that the individual systems and processes that support particular business services will be disrupted. If firms assume that disruption will occur then they will increase focus on the back-up plans, response plans and recovery options required to provide continuity of service, regardless of the cause of the disruption.

The Authorities note that, in the context of cyber incidents, the FPC has announced that, in line with its responsibility to mitigate systemic risk, it will set an "impact tolerance" for disruption to the delivery of certain vital services the financial system provides to the economy. The FPC's impact tolerance relates to the point at which the FPC judges that a disruption would begin to cause a material economic impact. The Authorities consider that firms and FMIs should derive their own impact tolerances for their business services and use them to set operational resilience standards, prioritize and take investment decisions. The Authorities suggest that the highest priority should be given to those business services that have the most potential to affect the firm or FMI's viability, harm consumers or threaten financial stability.

The Authorities expand in the discussion paper on the concept of impact tolerances and how they might complement existing requirements on firms. Impact tolerances express an upper limit where a breach is to be avoided in all but the most extreme scenarios, which can be contrasted with risk appetites or recovery time objectives, which tend to express a desired outcome that is achieved with high probability. Impact tolerances would need to be expressed clearly and would be separate from any risk appetites or recovery time objectives. The Authorities consider that engagement from firms' and FMIs' boards and senior management in setting impact tolerances and setting and overseeing business and operational strategies (including communication strategies) is crucial for ensuring operational resilience.

The Authorities consider that setting impact tolerances would support existing regulatory expectations and obligations and are reviewing the existing regulatory framework in the light of the overall approach set out in the discussion paper. This review has regard to existing international, EU and domestic requirements and regulatory frameworks. The Authorities outline that any future supervisory approach might cover the following four broad areas:

- sector-wide work, including any potential stress testing developed by the Bank and the PRA with input from the FPC;
- supervisory assessment of how firms and FMIs set and use impact tolerances;
- analysis of systems and processes that support business services; and
- requiring firms and FMIs to provide assurance to the Authorities that they have the capabilities to deliver operational resilience and are in compliance with existing rules, principles, expectations and guidance.



The Authorities hope to receive feedback from a broad range of stakeholders on the issues raised in the discussion paper. Comments on the discussion paper are invited by October 5, 2018.

The Discussion Paper (BoE/PRA DP 01/18; FCA DP 18/04) is available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/discussion-paper/2018/dp118.pdf>.

## Financial Services

### **UK Draft Regulations Restricting the Assignment of Receivables Published**

On July 6, 2018, the draft Business Contract Terms (Assignment of Receivables) Regulations 2018 were laid before Parliament. The draft Regulations will invalidate terms in business contracts that prohibit or restrict the assignment of receivables, including terms that prevent the enforcement of a receivable. A receivable in this context is a right to be paid under a contract for the supply of goods, services or intangible assets. The Regulations will not apply if the person to whom the receivable is owed is a large enterprise or a special purpose vehicle.

The Regulations will also not apply to certain types of contracts, including among others: (i) contracts regulated under the Consumer Credit Act 1974; and (ii) contracts for financial services as defined in the Small Business, Enterprise and Employment Act 2015, which includes, among others, the following types of financial services: financial leasing and loans, insurance, payment and money transmission services, providing guarantees or commitments, money brokering, asset management, settlement and clearing services for financial assets, derivatives and trading for own account or for account of customers, whether on an investment exchange, OTC or otherwise. Furthermore, contracts where none of the parties to the contract enter into the contract in the course of carrying on a business in the U.K. are excluded.

The draft Regulations will come into force on the day after the day on which they are made.

The draft Assignment of Receivables Regulations is available at:

[http://www.legislation.gov.uk/ukdsi/2018/978011171080/pdfs/ukdsi\\_978011171080\\_en.pdf?\\_sm\\_au\\_=iVV6W4V0DS4MFrRB](http://www.legislation.gov.uk/ukdsi/2018/978011171080/pdfs/ukdsi_978011171080_en.pdf?_sm_au_=iVV6W4V0DS4MFrRB) and the explanatory memorandum is available at:

[http://www.legislation.gov.uk/ukdsi/2018/978011171080/pdfs/ukdsiem\\_978011171080\\_en.pdf?\\_sm\\_au\\_=iVV6W4V0DS4MFrRB](http://www.legislation.gov.uk/ukdsi/2018/978011171080/pdfs/ukdsiem_978011171080_en.pdf?_sm_au_=iVV6W4V0DS4MFrRB).

### **UK Financial Conduct Authority Consults on a New Directory for Financial Services Workers**

On July 4, 2018, the FCA published a consultation paper setting out proposals to introduce a new directory of financial services workers.

In the consultation paper, the FCA explains that one effect of the extension of the SM&CR to all financial services firms will be that the Financial Services Register will contain the details of fewer individuals. Currently the Financial Services Register contains details of individuals who have been approved by the FCA or PRA. This includes individuals in senior management roles, individuals approved to hold controlled functions and individuals who hold customer-facing roles. However, this will change following the extension of SM&CR to all firms, because individuals in customer functions, for example, will need to be assessed as fit and proper by firms rather than being approved by the regulators. Only individuals in specified senior manager roles will be approved by the relevant regulators and entered on the Register.

The FCA is proposing to introduce a new directory, on which information relating to “directory persons” will be publicly accessible. The FCA envisages that directory persons will comprise:

- all staff holding a certification function under the SM&CR;

- non-senior manager function directors (both executive and non-executive); and
- other individuals who are sole traders or appointed representatives (including those within appointed representatives) where they are carrying on business with clients and require a qualification to do so.

In the consultation paper the FCA outlines the key features of the proposed directory:

- it would be centrally hosted by the FCA and freely accessible to the public, a single central location for information on Directory Persons and Senior Managers at all firms authorized under the Financial Services and Markets Act;
- its search capabilities will allow users to seek out suitable individuals; and
- firms would be responsible for keeping their information up to date, by reporting certain information on their directory persons to the FCA.

The FCA has published a prototype version of the directory user interface as an example of how the directory could work. The prototype is available via a webpage link and in pdf format. The FCA invites potential users of the directory to explore the prototype and provide feedback on their user experience.

The consultation paper also explains that certain improvements will be made to the financial services register to make it easier to use and understand.

Comments on the consultation are invited by October 5, 2018. The FCA aims to publish final rules in winter 2018. Final system testing will follow the publication of final rules, before the directory is formally launched.

The FCA consultation (FCA CP 18/19) is available at: <https://www.fca.org.uk/publication/consultation/cp18-19.pdf>, the webpage link to the prototype directory is available at: <https://www.fca.org.uk/publications/consultation-papers/cp18-19-introducing-directory> and the response form is available at: <https://www.fca.org.uk/cp18-19-response-form>.

## FinTech

### European Banking Authority Publishes First Outputs from Its FinTech Roadmap

On July 3, 2018, following the publication of its FinTech Roadmap in March 2018, the EBA published two reports contemplated by the Roadmap. The first report sets out the results of a thematic review of the impact of FinTech on the business models of incumbent credit institutions. The second report outlines the perceived benefits and potential prudential risks of seven FinTech use cases. The EBA has also established a FinTech Knowledge Hub for the sharing of information and experience and promotion of emerging trends among EU national regulators.

The Thematic Report is designed to provide an overview of the current FinTech landscape and changes that the EBA has observed in incumbent institutions' behavior in adopting financial technologies. The EBA also intends that the Thematic Report will help raise awareness and share knowledge of the main trends affecting business models and assist supervisors and other stakeholders in identifying and understanding the potential challenges to the sustainability of incumbents' business models. In the Thematic Report, the EBA analyzes in depth the main factors driving digitalization and technological innovation in incumbent institutions and identifies the four key drivers as: (i) rapidly evolving customer expectations and behavior; (ii) profitability concerns (driven largely by the low interest rate environment); (iii) increased competition from new entrants (such as digital-based institutions), other FinTech firms (such as FinTech start-ups) and technology providers, which are together impacting a number of business lines, in particular payment, settlement and retail banking

business lines; and (iv) regulatory changes, in particular the revised Payment Services Directive and the General Data Protection Regulation.

The Thematic Report provides a high-level overview of the extent to which incumbents have so far adopted technology-enabled financial innovations, such as biometrics, open banking/API strategies, cloud, machine learning/big data and blockchain. It considers the changes to incumbent credit institutions' strategies, internal organization and operations that innovation requires. It explores how incumbents interact with FinTech in a range of ways, from investing directly into new entrant FinTech firms to in-house development of technological solutions. Finally, the Thematic Report sets out five key risk factors that may affect the sustainability of incumbents' business models. These are: (i) digitalization strategies that incumbent institutions pursue to keep pace with a fast-changing environment; (ii) challenges arising from legacy ICT systems; (iii) operational capacity to implement the necessary changes; (iv) concerns over retaining and attracting staff; and (v) increasing risk of competition from peers and other FinTech firms.

The Prudential Risks and Opportunities Report has been prepared by the EBA with an objective to raise awareness and share information within the supervisory community. It does not make any recommendations and the EBA stresses that the report should not be considered as favoring or discouraging the application of any particular technology. The report provides an analysis of seven selected FinTech use cases, outlining for each the current landscape, underlying technologies, potential benefits and the potential microprudential risks that engagement with the technology might generate. While ICT risk is prevalent through many use cases and could be perceived as the key risk, the use of innovative technologies can potentially create new microprudential risks and amplify others. In varying degrees, depending on the use case, these include third-party risk through dependencies on third-party providers, ICT-outsourcing risk, ICT security and data integrity risks and legal, compliance, reputational and conduct risks. Some use cases also give rise to data privacy and data protection concerns. The report does not purport to provide an exhaustive list of prudential risks. The seven use cases considered are:

- Biometric authentication using fingerprint recognition.
- Use of robo-advisors for investment advice.
- Use of big data and machine learning for credit scoring.
- Use of Distributed Ledger Technology and smart contracts for trade finance.
- Use of DLT to streamline Customer Due Diligence processes.
- Mobile wallet with the use of Near Field Communication technology.
- Outsourcing core banking/payment system to the public cloud.

The EBA will continue to monitor FinTech developments in line with its Roadmap and further outputs can be expected as its work progresses.

The Thematic Report is available at:

<http://www.eba.europa.eu/documents/10180/2270909/Report+on+the+impact+of+Fintech+on+incumbent+credit+institutions%27+business+models.pdf>, the Prudential Risks and Opportunities Report is available at:

<http://www.eba.europa.eu/documents/10180/2270909/Report+on+prudential+risks+and+opportunities+arising+for+institutions+from+FinTech.pdf>, the EBA's FinTech Knowledge Hub is available at:

<http://www.eba.europa.eu/financial-innovation-and-fintech/fintech-knowledge-hub> and details of the EBA's

FinTech Roadmap is available at: <https://finreg.shearman.com/european-banking-authority-publishes-fintech-road>.

### **UK Regulator Announces Successful Applicants to Cohort 4 of Its Regulatory Sandbox**

On July 3, 2018, the FCA published a press release confirming the acceptance of 29 firms to begin testing in the fourth cohort of its regulatory sandbox.

The FCA's regulatory sandbox is part of Project Innovate, the FCA's initiative for encouraging innovation in the interest of consumers. On its launch in June 2016, the FCA sandbox was the first in the world and has since been emulated by regulators globally. The sandbox is open to authorized and unauthorized firms of all sizes and provides a controlled live environment for participating firms to test product and service innovations on a time-limited basis. Applicants to the sandbox must satisfy strict eligibility criteria to be able to test in the sandbox and testing is subject to appropriate safeguards for consumer protection which are set on a case-by-case basis. Cohort 4 had 69 applicants, which is the largest number of applicants to date.

In its press release, the FCA notes that there has been an increase in the number of firms testing wholesale propositions. In Cohort 4, over 40% of the propositions are using distributed ledger technology and a small number of propositions involve crypto-assets.

Testing in Cohort 4 will run for six months. The application window for Cohort 5 will open later in 2018.

The FCA press release is available at: <https://www.fca.org.uk/news/press-releases/fca-reveals-fourth-round-successful-firms-its-regulatory-sandbox>.

## **Payment Services**

### **US Federal Reserve Board Seeks Comment on Changes to Fedwire Funds Service Message Format**

On July 5, 2018, the U.S. Federal Reserve Board published a notice of proposed service enhancement and request for comment with respect to adopting the International Organization for Standardization (ISO) 20022 message format for the Fedwire Funds Service. The new format would replace the service's current proprietary message format. The proposal notes that the decision to implement the ISO 20022 message format standard is the result of a multi-year process, where the Federal Reserve Board and U.S. Federal Reserve Banks sought input from a number of stakeholders and industry participants, including The Clearing House Payments Company, which owns and operates the other main large-value payment system in the United States. The Federal Reserve Banks have also performed extensive public outreach on this topic, including the formation of advisory groups, the distribution of customer surveys, and the preparation of educational materials regarding the ISO 20022 standard. The proposal suggests that switching to the ISO 20022 standard may result in a number of benefits, including a richer and more structured message format, improved domestic and cross-border interoperability and the ability for financial institutions to provide additional services to customers. The proposal notes that the implementation of the ISO 20022 standard will consist of three phases, with a target final implementation date of November 2023. Comments to the proposal are due by September 4, 2018.

The full text of the Federal Reserve Board proposal is available at:  
<https://www.federalreserve.gov/newsevents/pressreleases/files/other20180705a1.pdf>.

### **UK Regulator Updates Guidance on the Approach to Payment Services and Electronic Money**

On July 6, 2018, the U.K. FCA updated its Approach Document on payment services and electronic money, to reflect final guidelines issued in December 2017 by the EBA on security measures for mitigating operational and security risks under the revised Payment Services Directive. The changes will affect all payment service providers. The FCA has also updated its webpage on reporting requirements for payment services providers

and e-money issuers to reflect these changes. The webpage includes a link to the revised version of the FCA's REP018 (operational and security risk) reporting form.

The FCA will expect payment services providers to comply with the EBA guidelines, which cover issues such as operational and security risk management framework governance, the use of models, outsourcing and how functions, processes and assets should be identified, classified and risk-assessed. The EBA guidelines also cover security of data integrity, systems and confidentiality as well as physical security and asset control and communication of the security measures to payment service users. PSPs will be expected to report at least annually to the FCA on their operational and security risk management frameworks

The updated Approach Document shows tracked changes from the previous version. The key changes in the Approach Document are:

- revisions to Chapter 13 (reporting and notifications); and
- revisions to Chapter 18 (operational and security risks).

Other minor changes have been made, to clarify the FCA's guidance or reflect legislative change, in Chapter 3 (Authorisation and registration), Chapter 4 (Changes in circumstances of authorisation or registration), Chapter 10 (Safeguarding) and Chapter 15 (Fees).

The Updated Guidance is available at: <https://www.fca.org.uk/publication/finalised-guidance/fca-approach-payment-services-electronic-money-july-2018-track-changes.pdf>, the updated webpage on reporting requirements is available at: <https://www.fca.org.uk/firms/reporting-requirements-payment-institutions> and details of the EBA Guidelines on PSD2 security measures for security and operational risks are available at: <https://finreg.shearman.com/european-banking-authority-issues-guidelines-for->.

### **UK Payments Regulators Announce Full Consolidation of UK Retail Payment Systems**

On July 2, 2018, the Payment Systems Regulator and the New Payment System Operator issued press releases confirming that the consolidation of U.K. retail payment systems is now complete. Consolidation of the three U.K. payment systems was one of the recommendations made in the Payments Strategy Forum's November 2016 report, which set out a wide-ranging strategy for reforming the U.K. retail payments industry.

The NPSO assumed responsibility for Bacs Payment Schemes Limited and Faster Payments Scheme Ltd on May 1, 2018. The NPSO's press release confirms that, as of July 1, 2018, the Cheque and Credit Clearing Company Limited has become a subsidiary of the NPSO and the NPSO has assumed responsibility for oversight of running and managing the cheque paper and cheque image clearing systems. All payments will continue to be processed through the cheque clearing systems. The NPSO has also acquired UK Payments Administration Ltd, which is the service company responsible for providing people, facilities and business services to the U.K. payments industry. The PSR confirms in its press release that its powers apply equally to NPSO in relation to the cheque clearing systems.

The NPSO press release is available at: <http://www.newpso.uk/news.html#nps023>, the PSR press release is available at: <https://www.psr.org.uk/psr-publications/news-announcements/consolidation-uk-retail-payment-systems-now-complete>, details of NPSO's responsibility for Bacs and Faster Payments are available at: <https://finreg.shearman.com/new-payment-systems-operator-for-uk-retail-paymen>, the NPSO's factsheet on its role and responsibilities is available at: [http://www.newpso.uk/180502\\_nps0factsheet.pdf](http://www.newpso.uk/180502_nps0factsheet.pdf) and the Payments Strategy Forum Recommendations are available at: [https://paymentsforum.uk/sites/default/files/documents/A%20Payments%20Strategy%20for%20the%20201st%20Century%20-%20Putting%20the%20needs%20of%20users%20first\\_0.pdf](https://paymentsforum.uk/sites/default/files/documents/A%20Payments%20Strategy%20for%20the%20201st%20Century%20-%20Putting%20the%20needs%20of%20users%20first_0.pdf).

## Recovery & Resolution

### **US Federal Reserve Board and US FDIC Publish Public Sections of July 2018 Resolution Plans**

On July 9, 2018, the U.S. Federal Reserve Board and FDIC published the public portions of the July 2018 resolution plans for four foreign banking organizations, which plans focus on the institutions' U.S. operations. The public sections of the resolution plans summarize certain elements of the plans and how the resolution plans would be executed. The public portions of the resolution plans are published exactly as submitted by the institutions and are available on the Federal Reserve Board and FDIC websites.

The full text of the FDIC and Federal Reserve Board press releases are available at:

<https://www.fdic.gov/news/news/press/2018/pr18045.html> and

<https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180709a.htm>.

### **US Regulators Extend Resolution Plan Filing Deadline for 14 US Financial Institutions**

On July 2, 2018, the U.S. Federal Reserve Board and FDIC announced that they were extending the filing deadline for the resolution plans of 14 U.S. financial institutions to December 31, 2019. The agencies note that the deadline was extended to allow for additional time to provide feedback to these institutions with respect to their last resolution plan submissions and for the institutions to file their next resolution plan submissions. The agencies also reiterated that, pursuant to the Economic Growth, Regulatory Reform, and Consumer Protection Act, financial institutions with less than \$100 billion in total consolidated assets are no longer subject to resolution plan requirements, and that over the course of the next 18 months, the agencies will determine which financial institutions with \$100 billion or more, but less than \$250 billion in total consolidated assets will be subject to the resolution plan process going forward.

The full text of the FDIC and Federal Reserve Board press releases are available at:

<https://www.fdic.gov/news/news/press/2018/pr18041.html> and

<https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180702a.htm>.

### **European Central Bank Publishes Best Practices for Eurozone Recovery Plans**

On July 3, 2018, the ECB published a report on recovery plans. The ECB is responsible for direct prudential supervision of certain significant banks based in the Eurozone as part of the Single Supervisory Mechanism. Under that remit, the ECB has analyzed the recovery plans of numerous Eurozone banks. The report sets out the ECB's experience of that process and best practices that have been adopted by some banks. The report is intended to assist Eurozone banks to improve their recovery planning, although the report itself is restricted to the recovery plans of significant institutions.

The ECB's report is available at:

<https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.reportrecoveryplans201807.en.pdf?fa1ecc99e42320376eafda8cba80327e>.

## Securities

### **UK Standard on Risk Management Transactions for New Issuances for the Fixed Income Markets**

On July 3, 2018, the U.K. Fixed Income, Currency and Commodities Markets Standards Board published a new Standard on Risk Management Transactions for New Issuances for the Fixed Income markets.

The FMSB has created several Standards to improve conduct in the FICC markets since its establishment in 2015 in response to the Fair and Effective Markets Review conducted by HM Treasury, the BoE and the FCA.

FMSB members commit to applying the FMSB Standards but the Standards do not impose legal or regulatory obligations.

The new Standard describes expected behaviors to improve the practice and awareness regarding risk management activities conducted in and around the new issuance of bonds and includes 12 Core Principles. Following its consultation at the end of 2017 on the proposed Standard on Risk Management Transactions for New Issuances, the FMSB has made some minor changes, including providing more detail on the nature of the conduct risks and amending the Principle on dissemination of information (Core Principle 9).

The new Standard applies to all market participants directly involved in Risk Management Transactions that are linked to syndicated offerings of fixed income bonds in the wholesale primary bond markets in Europe, subject to any applicable local regulatory restrictions. Auctions and buybacks of sovereign, supranational or corporate debt, or issuance of securitized debt or commercial paper are out of the scope of the Standard.

The Standard is available at: [https://fmsb.com/wp-content/uploads/2018/07/Risk-Management-Transactions-for-New-Issuance-standard-Final-3-July-2018\\_v4.pdf](https://fmsb.com/wp-content/uploads/2018/07/Risk-Management-Transactions-for-New-Issuance-standard-Final-3-July-2018_v4.pdf).

## Upcoming Events

July 12, 2018: U.S. Senate Committee on Banking, Housing, and Urban Affairs hearing: “An Overview of the Credit Bureaus and the Fair Credit Reporting Act.”

July 12, 2018: U.S. House Financial Services Committee hearing: “Countering the Financial Networks of Weapons Proliferation.”

July 12, 2018: U.S. House Financial Services Committee hearing: “The Annual Testimony of the Secretary of the Treasury on the State of the International Financial System.”

July 25, 2018: EBA public hearing on draft Guidelines on the conditions to be met to benefit from an exemption from contingency measures under the RTS on strong customer authentication and common and secure communication

July 31, 2018: ECB public hearing on a draft Regulation proposing the materiality threshold for credit obligations past due under the CRR

September 4, 2018: EBA public hearing on its consultation on draft RTS for calculation of KIRB for securitized exposures

September 4, 2018: EBA public hearing on its consultation on draft Guidelines on outsourcing arrangements

September 4–5, 2018: OECD blockchain conference: Unleashing the potential and facing the challenges of blockchain (registration closes August 30, 2018)

October 15, 2018: SRB Conference 2018 - 10 years after the crisis: are banks now resolvable?

November 28, 2018: EBA 7th Annual Research Workshop - Reaping the benefits of an integrated EU banking market

## Upcoming Consultation Deadlines

July 13, 2018: U.S. Federal Reserve Board, FDIC and OCC proposed amendments to regulatory capital rules to address changes to U.S. GAAP

July 13, 2018: ECB consultation on potential replacements for the EONIA benchmark

- July 17, 2018: EBA consultation on draft Guidelines on the exposures to be associated with high risk
- July 18, 2018: BoE consultation on ISO 20022 migration for U.K. payment systems
- July 20, 2018: EBA consultation on draft guidelines on STS criteria for ABCP securitization
- July 20, 2018: EBA consultation on draft guidelines on STS criteria for non-ABCP securitization
- July 24, 2018: European Commission proposal for a regulation on Sovereign Bond-Backed Securities
- July 24, 2018: European Commission consultation on a proposed Regulation amending the Benchmarks Regulation
- July 25, 2018: European Commission consultation on a proposal for Regulation amending MAR and the PR to promote SME Growth Markets
- July 27, 2018: EBA consultation on draft Guidelines on disclosure of non-performing and forborne exposures
- August 13, 2018: EBA consultation on draft Guidelines on the conditions to be met to benefit from an exemption from contingency measures under the RTS on strong customer authentication and common and secure communication
- August 17, 2018: ECB consultation on a draft Regulation proposing the materiality threshold for credit obligations past due under the CRR
- August 17, 2018: FATF consultation on draft Risk-Based Approach Guidance for the securities sector
- August 20, 2018: FSB call for feedback on the technical implementation of the TLAC Standard
- August 20, 2018: FSB consultation on a draft cyber lexicon
- August 22, 2018: PRA consultation on Securitization: the new EU framework and significant risk transfer
- September 3, 2018: PSR discussion paper on use of data in the payments industry
- September 4, 2018: CFTC's proposed amendments to SRO surveillance programs for FCMs
- September 4, 2018: Comment deadline for the U.S. Federal Reserve Board's Fedwire Funds Service new message format proposal
- September 19, 2018: EBA consultation on draft RTS for calculation of KIRB for securitized exposures
- September 24, 2018: EBA consultation on draft Guidelines on outsourcing arrangements
- September 25, 2018: PRA consultation on reflecting the Systemic Risk Buffer framework within the Leverage Ratio framework for U.K. systemic ring-fenced bodies
- October 5, 2018: BoE/PRA/FCA Discussion Paper on operational resilience of firms and FMIs
- October 5, 2018: FCA consultation on a new workers directory



**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:**

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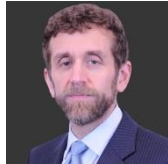
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