



## Financial Regulatory Developments Focus

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

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## Bank Prudential Regulation & Regulatory Capital

### Federal Banking Agencies Release Statement on Annual Stress Tests at Medium-Sized Financial Companies

On June 2, 2015, the US Board of Governors of the Federal Reserve System, the US Federal Deposit Insurance Corporation and the US Office of the Comptroller of the Currency (collectively, the Federal banking agencies), released a statement reiterating the disclosure requirements for the annual company-run stress tests conducted by financial institutions with total consolidated assets between \$10 billion and \$50 billion. In the statement, the Federal banking agencies emphasized the requirement for such medium-sized firms to disclose certain information regarding the annual stress tests, including: (i) a description of the types of risks included in the stress test; (ii) a summary description of the methodologies used to conduct the stress test; (iii) estimates of losses, revenue, and net income; (iv) post-stress capital ratios; and (v) an explanation of the most significant causes for the changes in regulatory capital ratios. In addition, as the Federal banking agencies have previously stated, the company-run stress tests are intended to produce hypothetical results and are not intended to be forecasts or expected outcomes.

Stress test results must be disclosed between June 15, 2015 and June 30, 2015. Any questions regarding the disclosures made in connection with the stress tests should be directed to the firms.

The statement released by the Federal banking agencies is available at:

<https://www.fdic.gov/news/news/press/2015/pr15045a.pdf>.

### Extension of Transitional Provisions for Exposures to CCPs Formally Announced

Following the announcement by the European Commission on June 4, 2015, that the transitional period for regulatory capital requirements for EU banks' exposures to CCPs under the EU Capital Requirements Regulation would be extended from June 15, 2015 to December 15, 2015, the Implementing Regulation was published in the Official Journal of the European Union on June 9, 2015. The Implementing Regulation comes into effect on June 12, 2015. The extension is intended to allow further time for CCPs, both from the EU and from non-EU jurisdictions, to become authorized or recognized under the European Market Infrastructure Regulation. One of the requirements for recognition of a third country CCP is that the third country's regime for supervision of CCPs is deemed to be equivalent to that of the regime under EMIR. Equivalence decisions for CCP regimes have only been given for Hong Kong, Singapore, Australia and Japan. Decisions for major jurisdictions, such as the US, are still outstanding. Authorization or recognition under EMIR will give the CCP the status of being a Qualifying CCP, which is relevant for clearing member firms to calculate their capital requirements for exposures to CCPs under the CRR. Lower capital requirements will be imposed for exposures to a QCCP than for exposures to a non-QCCP CCP.

The Implementing Regulation is available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL\\_2015\\_143\\_R\\_0003&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2015_143_R_0003&from=EN).

You may like to see our client note on third country equivalence under EMIR, available at:

<http://www.shearman.com/~media/Files/NewsInsights/Publications/2015/05/Update-On-Third-Country-Equivalence-Under-EMIR-FIA-052815.pdf>.

### Amending Regulation on Own Funds Requirements in Force

On June 2, 2015, the Amending Regulation setting out Regulatory Technical Standards on own funds requirements for institutions under CRD IV was published in the Official Journal of the European Union. The Amending Regulation applies to banks and investment firms and specifies the conditions in which a drag on own funds is disproportionate in terms of distributions on: (i) an individual Common Equity Tier 1 instrument; and (ii) the total own funds of the firm. The Amending Regulation also deals with preferential distributions regarding preferential rights to payments of distributions as well as preferential distributions regarding the order of distribution payments. The Amending Regulation enters into effect on June 22, 2015.

The Regulation is available at:

[http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2015.135.01.0001.01.ENG.](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.135.01.0001.01.ENG.)

### **European Banking Authority Publishes Questionnaire on Regulatory Equivalence of Third Countries**

On June 2, 2015, the European Banking Authority published a questionnaire on the assessment of third country equivalence with the regulatory and supervisory framework under the Capital Requirements Directive IV package. The questionnaire aims to assess whether third countries apply regulatory and supervisory provisions equivalent to those in the EU framework. The questionnaire will be sent to certain third countries so that the regimes of those countries can be assessed. For third countries that are deemed to be equivalent, more favorable treatment in terms of capital requirements could be available for EU credit institutions with relevant exposures to entities located in these countries, though only after the European Commission adopts an Implementing Decision determining the equivalence of the third country's prudential supervisory and regulatory requirements.

The questionnaire is available at: [http://www.eba.europa.eu/documents/10180/1094990/Annex+I+-+EBA+questionnaire+on+regulatory+equivalence\\_publication.pdf](http://www.eba.europa.eu/documents/10180/1094990/Annex+I+-+EBA+questionnaire+on+regulatory+equivalence_publication.pdf).

### **Final Draft Regulatory Technical Standards on Advanced Measurement Approaches for Calculating Capital Requirements for Operational Risk**

On June 5, 2015, the EBA published a final report, dated June 3, 2015, including final draft RTS on the criteria that national regulators must take into account before allowing firms to use the Advanced Measurement Approaches for calculating capital requirements for operational risk under the CRR. The draft RTS aim to encourage regulatory harmonization across the European Union and also detail the assessment methodology that is to be used by national regulators. The draft RTS cover: (i) the qualitative and quantitative criteria that firms must meet before they are granted permission to use AMA models; (ii) the criteria for the supervisory assessment of key methodological components of the operational risk measurement system; and (iii) the common standards for the supervisory assessment of a bank's operational risk governance.

The final draft RTS are available at: <http://www.eba.europa.eu/documents/10180/1100516/EBA-RTS-2015-02+RTS+on+AMA+assessment.pdf>.

### **UK Prudential Regulation Authority Publishes Final Rules on Approach to Regulating Liquidity**

On June 8, 2015, the PRA published a Policy Statement setting out the final rules on its approach to regulating liquidity under the CRR. The Policy Statement provides feedback on the responses received by the PRA to the consultation on liquidity published in November 2014, and refers to a new Supervisory Statement on supervisory liquidity and funding risks which was published on the same day. The Policy Statement is aimed at UK banks, EEA banks with a branch in the UK, PRA-designated investment firms, as well as third country banks or PRA-designated investment firms. The Policy Statement includes new rules and feedback on issues related to: (i) the phasing-in of the Liquidity Coverage Requirement and additional liquidity requirements on top of the LCR; (ii) liquidity reporting and disclosure, including changes made to address concerns about the increased and burdensome volume of liquidity data that is to be reported; and (iii) interim LCR reporting. The Supervisory Statement deals with issues including (i) the Internal Liquidity Adequacy Assessment Process; (ii) the liquidity supervisory review and evaluation process; (iii) the drawing down of liquid asset buffers; (iv) collateral placed at the Bank of England; and (v) reporting of liquidity positions. The rules and Supervisory Statement come into effect on October 1, 2015, with the exception of Annex E, which will delete the requirement to submit certain liquidity returns and which will enter into force following a further review.

The policy statement and supervisory statement are available at:

<http://www.bankofengland.co.uk/pradocuments/publications/ps/2015/ps1115.pdf>; and  
<http://www.bankofengland.co.uk/pradocuments/publications/ss/2015/ss2415.pdf>.

### **Basel Committee on Banking Supervision Launches Consultation on Interest Rate Risk in the Banking Book**

On June 8, 2015, the Basel Committee on Banking Supervision published a consultation paper on the risk management, capital treatment and supervision of interest rate risk in the banking book. The proposals expand upon, and are intended to ultimately replace, the Basel Committee's 2004 Principles for the Management and Supervision of Interest Rate Risk. The objectives of the proposals are to help ensure that banks have appropriate capital to cover potential losses from exposures to changes in interest rates and to limit capital arbitrage between the trading book and the banking book, as well as between banking book portfolios that are subject to different accounting treatments. The published proposal presents two options for the capital treatment of interest rate risk in the banking book: (i) a Pillar 1 (Minimum Capital Requirements) approach; and (ii) an enhanced Pillar 2 approach. Comments to the proposal are due by September 11, 2015.

The consultation document is available at: <http://www.bis.org/bcbs/publ/d319.pdf> and the 2004 Principles for the Management and Supervision of Interest Rate Risk is available at: <http://www.bis.org/publ/bcbs108.pdf>.

## **Compensation**

### **US Securities and Exchange Commission Provides Additional Analysis Related to Proposed Pay Ratio Disclosure Rules**

On June 4, 2015, the US Securities and Exchange Commission's Division of Economic and Risk Analysis published additional analysis related to its proposed rules for pay ratio disclosure. Among other things, the analysis considers the potential effects of excluding different percentages of employees from the pay ratio calculation.

In September 2013, the SEC proposed rules that would require the disclosure of the median of the annual total compensation of all employees of the issuer, the annual total compensation of the chief executive officer of the issuer and the ratio of the median of the annual total compensation of all employees of the issuer to the annual total compensation of the chief executive officer of the issuer. The analysis and proposed rules are available for public comment until July 6, 2015.

The SEC analysis is available at: <http://www.sec.gov/comments/s7-07-13/s70713-1556.pdf> and the proposed SEC rules for pay ratio disclosure are available at: <http://www.sec.gov/rules/proposed/2013/33-9452.pdf>.

## **Credit Ratings**

### **International Organization of Securities Commissions Publishes Final Report on Good Practices on Reducing Reliance on CRAs in Asset Management**

On June 8, 2015, the International Organization of Securities Commissions published its final report titled Good Practices on Reducing Reliance on CRAs in Asset Management, which lists a set of eight good practices intended to help asset managers avoid over-reliance on external credit ratings in the industry. To address concerns, IOSCO recommends that the Financial Stability Board consider potential ways to reduce possible investor overreliance on external ratings which are driven by regulatory requirements, such as those in the Basel framework or the Solvency regime applicable to insurers. The report highlights the importance of asset managers having the appropriate expertise and processes in place to evaluate and manage the credit risk associated with their investments.

The IOSCO Final Report is available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD488.pdf>.

## Derivatives

### **US Commodity Futures Trading Commission Issues No-Action Relief to International Financial Institutions from Broker and Commodity Trading Advisor Registration**

On June 5, 2015, the US Commodity Futures Trading Commission's Division of Swap Dealer and Intermediary Oversight issued no-action relief from introducing broker and commodity trading advisor registration to persons located outside the US that facilitate swap transactions for International Financial Institutions that have offices in the US. The relief granted by the DSIO is consistent with prior treatment of IFIs, including for purposes of the swap dealer definition and mandatory clearing requirements.

The definition of IFIs, for purposes of the no-action letter and in accordance with prior CFTC policy, is limited to certain specified institutions and organizations, including but not limited to, the International Monetary Fund, the International Bank for Reconstruction and Development, the European Bank for Reconstruction and Development and the International Development Association, among others.

CFTC Staff Letter 15-37 is available at: <http://www.cftc.gov/ucm/groups/public/@lrlattergeneral/documents/letter/15-37.pdf>.

### **European Commission Announces Extension of Exemption from Clearing Obligation for Pension Funds**

On June 5, 2015, the European Commission announced an extension of the exemption from the clearing obligation for pension funds from August 16, 2015 to August 16, 2017. The announcement was accompanied by a draft Commission Regulation which will, once it has come into effect, amend EMIR to give effect to the extension. The Commission noted that if pension funds were subject to the clearing obligation now, they would need to source cash for the margin requirements of CCPs. The Commission, and other EU regulators, have asked CCPs to develop a solution that would allow pension funds to clear derivatives without the obligation being too burdensome for pension funds but which will also allow CCPs to liquidate positions rapidly in the event of a default. To date, no solution has been confirmed.

The draft Commission Regulation is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2015/EN/3-2015-3680-EN-F1-1.PDF>.

## Enforcement

### **Lloyds Banking Group Fined for Failures to Handle PPI Complaints Fairly**

On June 4, 2015, the Financial Conduct Authority issued a final notice imposing a fine of £117m on Lloyds Bank Plc, Bank of Scotland Plc and Black Horse Ltd (together LBG). The fine relates to the unfair approach of LBG's complaint handling operations and failures to treat customers fairly when handling Payment Protection Insurance complaints between March 2012 and May 2013. In handling PPI complaints, LBG designed and implemented a policy which sought to comply with the rules and guidance of UK regulators. However, during the relevant period, LBG advised its complaint handlers that LBG's PPI sales processes had been "compliant and robust," unless notified otherwise. This was described as "the Overriding Principle." The Overriding Principle affected the judgments of some complaint handlers who relied on this principle to dismiss customer accounts of what had happened during the PPI sale, and some complaints were therefore not fully investigated. LBG also failed to notify its complaints handlers of the known failings of its sales of PPI. The investigation showed that a significant number of customer complaints were rejected unfairly due to these reasons. The FCA found that customers who had originally been mis-sold PPI and treated unfairly were once again treated unfairly and denied the redress that was owed to them.

The final notice is available at: <http://www.fca.org.uk/static/fca/documents/lloyds-banking-group-2015.pdf>.

## Financial Market Infrastructure

### UK Financial Conduct Authority Consults on Fair, Reasonable and Non-Discriminatory Access to Regulated Benchmarks

On June 3, 2015, the FCA published a consultation paper setting out proposals for fair, reasonable and non-discriminatory access to regulated benchmarks by benchmark administrators. This is further to the policy statement published by the FCA in March 2015 on the seven new benchmarks it will be regulating and supervising. The policy statement included the FCA's final rules amending Chapter 8 of the Market Conduct Sourcebook (MAR 8), originally designed for benchmarks determined through a submission process, such as LIBOR. The FCA's proposals are in response to concerns raised about the unconstrained ability of administrators to set the prices of access to benchmark information and benchmark licenses. The new proposals limit the ability of benchmark administrators to exploit their market power in a way that could encourage unfair competition. The new rules would apply to existing and future pricing and licensing arrangements and would not apply retrospectively. Responses are due before August 3, 2015 and the FCA aims to publish a policy statement and final rules towards the end of 2015.

The consultation paper is available at: <http://www.fca.org.uk/static/fca/documents/consultation-papers/cp15-18.pdf>.

## Financial Services

### EU Revised Anti-Money Laundering and Terrorist Financing Framework Comes into Effect

On June 5, 2015, the revised EU Directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (the "4<sup>th</sup> Anti-money Laundering Directive" or "4MLD") and the Regulation on information accompanying transfers of funds were published in the Official Journal of the European Union. Together, the legislation represents the revised EU framework on anti-money laundering and terrorist financing. Member States have until June 26, 2017 to transpose the requirements of the 4<sup>th</sup> Anti-money Laundering Directive into national law. The 4<sup>th</sup> Anti-money Laundering Directive will repeal, from June 26, 2017, the current anti-money laundering Directive and its related Implementing Directive. The Regulation will apply directly in all Member States from June 26, 2017 and will repeal the 2006 Regulation on information on the payer accompanying transfers of funds from that date.

The 4<sup>th</sup> Anti-money Laundering Directive is available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL\\_2015\\_141\\_R\\_0003&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2015_141_R_0003&from=EN) and the Regulation is available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL\\_2015\\_141\\_R\\_0001&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2015_141_R_0001&from=EN).

### UK Changes to Pension Transfer Rules Come into Effect

On June 8, 2015, the FCA published a Policy Statement and final rules on changes to the pension transfer rules. The amendments, which were consulted on in March this year, are needed to ensure that the rules reflect the change to legislation that made it a regulated activity to advise on the conversion or transfer of safeguarded pension benefits into flexible benefits. The FCA has also made changes to the Conduct of Business rules so that pension transfer requirements apply to all pension transfers, regardless of when the transferred benefits are accessed. The new rules came into force on June 8, 2015.

The Policy Statement is available at: <http://www.fca.org.uk/static/fca/documents/policy-statements/ps15-12.pdf>.

## People

### Bank of England Appoints Executive Director for Banking, Payments and Financial Resilience

On June 5, 2015, the Bank of England announced the appointment of Andrew Hauser as Executive Director for Banking, Payments and Financial Resilience, effective September 1, 2015.

**Financial Conduct Authority Appoints Enforcement and Market Director and Risk and Compliance Director**

On June 5, 2015, the FCA announced the appointments of Mark Steward as the new Director of Enforcement and Market Oversight and Barbara Frohn as the new Director of Risk and Compliance Oversight.

**Upcoming Events**

June 11, 2015: EBA public hearing on draft ITS on the mapping of External Credit Assessment Institutions' for securitization positions.

June 17 and 18, 2015: IOSCO Annual Conference.

July 2, 2015: EBA public hearing on methodologies for the valuation of derivative liabilities.

July 3, 2015: EBA workshop on proportionality measures for regulatory purposes.

July 6, 2015: EBA public hearing on assigning risk weights to specialized lending exposures.

July 16 and 29, 2015: SEC outreach programs to aid firms in compliance with Regulation Systems Compliance and Integrity.

July 22, 2015: FCA Annual Public Meeting 2015.

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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