SHEARMAN & STERLING LLP

FINANCIAL INSTITUTIONS ADVISORY & FINANCIAL REGULATORY GROUP NEWSLETTER

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Financial Regulatory Developments Focus

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

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

In this Issue (please click on any title to go directly to the corresponding discussion):

Bank Prudential Regulation & Regulatory Capital

US Office of Financial Policy and Research Renamed

On May 11, 2016 the US Board of Governors of the Federal Reserve System announced that the Office of Financial Policy and Research has been renamed as the Division of Financial Stability and designated as a division of the Federal Reserve. Federal Reserve economist Nellie Liang, who was appointed to establish the office in November 2010, will stay on as director. The Division of Financial Stability is responsible for the Federal Reserve's work on financial stability, including coordinating its interagency and international work, and its role as a member of the Financial Stability Oversight Council and the Financial Stability Board. According to the press release, the change reflects the growth in responsibilities and staffing of the Division.

The press release is available at: http://www.federalreserve.gov/newsevents/press/other/20160511a.htm.

US Office of the Comptroller of the Currency Releases Mid-Cycle Status Report

On May 11, 2016, the US Office of the Comptroller of the Currency released a mid-cycle status report on key actions that it has taken to date pursuant to its Committee on Bank Supervision's annual operating plan for the fiscal year that commenced on October 1, 2015. The plan sets forth the agency's broad supervision priorities and objectives and is used to develop individual bank supervisory strategies and make related resource allocation decisions. Key actions completed in the first half of fiscal year 2016 include issuing various supervisory communications, including 557 reports of examination, conducting workshops, issuing guidance and reports surveying best practices and ongoing outreach meetings and presentations to industry members. The OCC's supervisory priorities for the duration of the 2016 fiscal year include compliance, operational resiliency, credit risk management, stress testing, strategic planning and execution, corporate governance and interest rate risk.

The OCC's mid-cycle status report is available at: http://www.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-54a.pdf.

US Federal Reserve Bank of New York Executive Vice President Discusses Importance of Liquidity Regulations

On May 4, 2016, Executive Vice President of the US Federal Reserve Bank of New York Simon Potter discussed steps the US Board of Governors of the Federal Reserve System has taken to improve the US monetary policy framework following the financial crisis in line with its principles of returning to normalization. He discussed the importance of creating a framework that can provide liquidity for monetary policy implementation and transmission. However, Potter noted that there are important tradeoffs to consider, in that financial market participants may anticipate that central banks, like the Federal Reserve, will make liquidity abundant during times of stress and manage their own liquidity conservatively. He suggested that the Basel III liquidity regulations, namely the liquidity coverage ratio which the US has adopted and the net stable funding ratio which the Federal Reserve has recently proposed, help to mitigate the risk that banks would rely too much on the central bank for liquidity. Potter also noted the importance of the US monetary policy framework being transparent in order to enable market participants to make better-informed decisions. Specifically, drawing parallels to the financial crisis, he observed that a central bank can help foster the contribution of liquidity to the financial system by market participants by committing itself to maintain liquidity.

Potter's speech is available at: https://www.newyorkfed.org/newsevents/speeches/2016/pot160504

EU Regulation on Conditions for Derogation from the Liquidity Coverage Requirement

On May 13, 2016, a Commission Delegated Regulation containing Regulatory Technical Standards specifying the conditions for the application of derogations, concerning currencies with constraints on the availability of liquid assets, under the Capital Requirements Regulation was published in the Official Journal of the European Union. The CRR sets out a Liquidity Coverage Requirement which requires firms to hold liquid assets to maintain adequate levels of liquidity buffers to cope with any possible imbalances between liquidity inflows and outflows. Firms may derogate from the LCR where the requirement exceeds the availability of those assets in a particular currency.

The RTS sets out the conditions for a firm to apply the CRR's provisions on derogation of currency constrains and the availability of liquid assets. A firm must notify its regulator of its intention to apply one or both of the derogations in writing 30 days before the application of the first derogation or if it wants to materially amend the application of a derogation. To be eligible for the derogations, a firm must satisfy the conditions that determine whether the derogation is justified - the firm must have reduced the need for liquid assets in the full range of business conducted by the firm and the firm's holding of liquid assets must be consistent with the availability of those assets in the relevant currency. In December 2016, an EU Regulation was published which identified the Norwegian Krone as a currency with constraints on the availability of liquid assets.

The RTS enter into force on June 2, 2016 and will apply directly across the EU.

The Delegated Regulation can be viewed at:

http://eur-lex.europa.eu/legal-ontent/EN/TXT/?uri=uriserv:OJ.L_.2016.125.01.0001.01.ENG&toc=OJ:L:2016:125:TOC

European Supervisory Authorities Reject Proposed Amendments to Technical Standards on ECAIs Credit Assessments

On May 12, 2016, the European Banking Authority, European Securities and Markets Authority and European Insurance and Occupational Pensions Authority (known as the Joint Committee of the European Supervisory Authorities) published an Opinion on the European Commission's proposed amendments to the ESA's final draft Implementing Technical Standards on the mapping of credit assessments to the risk weights of External Credit Assessment Institutions under the Capital Requirements Regulation and Solvency II Directive. The ESA's submitted their final draft ITS to the European Commission in November 2015. The Commission notified the ESAs on March 30, 2016 that it intended to adopt the ITS with amendments by relaxing the ESA's approach to the mapping of ECAIs. The ESA's do not agree with the proposed amendments for several reasons including the fact that the Commission's approach favors promoting competition over financial stability risk concerns.

The Opinion is available at:
http://www.eba.europa.eu/documents/10180/1359456/ESAs+2016+41+%28Joint+Opinion+on+EC+amend+ITS+ECAIs+Mapping+CRR%29.pdf.

European Banking Authority Consults on LCR Disclosure and Disclosure of Liquidity Risk Management

On May 11, 2016, the EBA published a consultation paper on draft guidelines on liquidity coverage ratio disclosures, to complement the disclosure requirements of liquidity risk management under the CRR. The CRR provides general disclosure framework for firms for each category of risk where liquidity risk should be considered. Disclosure of ratios and figures to regulators is required under the CRR, in particular, ratios and figures that provide external stakeholders with a comprehensive view of the firm’s management of risk. In January 2015 the LCR Delegated Act was published, specifying the LCR for credit institutions. The ratio targets ensure that credit institutions maintain an adequate level of liquidity buffer to cover net liquidity outflows in the context of stressed conditions over a period of thirty days. The EBA proposes these draft guidelines to harmonize and specify disclosures required under the general principles in the CRR on liquidity and LCR.

The draft guidelines include a qualitative and quantitative harmonized table for the disclosure of information on liquidity risk management, as well as quantitative and qualitative harmonized templates with corresponding instructions, for the disclosure of information on the LCR composition.

The consultation seeks feedback on, among other things, the scope of application of the guidelines and whether the instructions are sufficiently clear. Responses to the consultation paper are due by August 11, 2016.

The consultation paper is available at: http://www.eba.europa.eu/documents/10180/1460976/EBA-CP-2016-06+%28CP+on+GL+on+LCR+disclosure%29.pdf.

European Banking Authority Argues for Powers to Update Benchmarking Portfolios for Annual Benchmarking Exercise

On May 12, 2016, the EBA published an Opinion on the European Commission's proposed amendments to the EBA's final draft ITS on benchmarking of internal approaches to regulatory capital. The Capital Requirements Directive sets out a framework for supervisory benchmarking of the internal approaches that EU firms use to calculate own-funds requirements for credit and market risk exposures. The final draft ITS, submitted by the EBA to the Commission in March 2015, include the benchmarking portfolios, templates, definitions and IT solutions for usage in that exercise. On April 16, 2016, the European Commission informed the EBA that it intended to adopt the final draft ITS with amendments. The Commission's proposed amendments are those agreed with the EBA following the 2014-2015 supervisory benchmarking exercise. In the Opinion, the EBA confirmed its agreement to the Commission's proposed amendments to the ITS and recommended that the benchmarking portfolios, detailed reporting templates and instructions should not be included in the ITS going forwards, because they will need to be updated annually prior to each supervisory benchmarking exercise. The EBA proposes that it should be given new powers to update the benchmarking portfolios, detailed reporting templates and instructions, so that the updates can be done more quickly and allowing firms more time to prepare for the annual exercise.

The EBA's Opinion is available at: http://www.eba.europa.eu/documents/10180/1461618/EBA-Op-2016-09+EBA+Opinion+on+Commission+amendments+to+ITS+on+benchmarking+of+internal+approaches.pdf and the EBA's letter to the Commission is available at: http://www.eba.europa.eu/documents/10180/1461618/%28EBA+2016+D+698%29%20Letter+to+O.+Guersent%2C%20DG+FISMA%2C%20EBA+Opinion+on+ITS+on+Benchmarking.pdf.

European Central Bank Announces Assessment of Four Banks in 2016

On May 10, 2016, the Banking Supervision division of the European Central Bank announced that it is currently undertaking comprehensive assessments of four European Banks. The banks being assessed are Abanka d.d. (Slovenia), Akciju sabiedrība "Rietumu Banka" (Latvia), Banca Mediolanum S.p.A. (Italy) and Citibank Europe Plc (Ireland). The assessments are being undertaken separately to the EBA stress test. The assessments commenced in March 2016 and the ECB expects results to be published in November 2016.

The announcement is available at: https://www.bankingsupervision.europa.eu/press/pr/date/2016/html/sr160510.en.html.

European Banking Authority Seeks Feedback on Risks and Benefits of Modern Use of Consumer Data by Financial Institutions

On May 4, 2016, the EBA published a discussion paper on innovative uses of consumer data by financial institutions. The focus of the paper is the risks and benefits to consumers and financial institutions arising from the use of commercially available data. Recent innovations include financial institutions combining consumer data they hold internally with data sourced externally from private and public companies and social media. Financial institutions are able to use consumer data, such as buyer behavior, to provide incentives such as shopping discounts to increase consumer consumption of financial services. Benefits for consumers of such innovative usage may include cost reductions and improved quality in products and services offered as financial institutions can more accurately cater to customer needs. Financial institutions can benefit through the creation of new sources of revenue, achieved through better product and service development and sharing consumer data with third parties.

However, use of consumer data by financial institutions also poses risks to consumers. The use of consumer data may create an information asymmetry, especially where the consumer is unaware that a financial institution is utilizing their data. Furthermore, consumers may also experience breaches of privacy whilst being unaware that their information is being used by either financial institutions or third parties. There is also risk to financial institutions. For example, firms may be exposed to reputational risk if they make questionable decisions about consumers based on their data if the firm does not take into account enough data or do not use the data that they hold in the right way. Data security is also a major risk for financial institutions. Risks can materialize where a firm's IT system is hacked or accessed by a third party, which may result in litigation following unauthorized payment transactions or breach of privacy claims. The EBA is seeking feedback on whether identified innovative uses of consumer data are comprehensive, reflect current practices and whether the risks and potential benefits are correctly reflected. The EBA will assess responses and then decide what, if any, steps it should take. Responses to the discussion paper are due by August 4, 2016.

The EBA update and discussion paper is available at: http://www.eba.europa.eu/news-press/calendar?p_p_auth=yUwvpRa2&p_p_id=8&p_p_lifecycle=0&p_p_state=normal&p_p_mode=view&_8_struts_action=%2Fcalendar%2Fview_event&_8_eventId=1455505.

UK Prudential Regulation Authority Consults on Pillar 2 Liquidity Risk Requirements

On May 12, 2016, the Prudential Regulation Authority published a consultation paper on its proposed approach to Pillar 2 liquidity requirements for intraday risk, debt buyback and non-margined derivatives, including a proposed policy statement. The CRD gives national regulators discretion to set Pillar 2 liquidity requirements, in addition to the standard Pillar 1 LCR which applies to all firms. The PRA is proposing that: (i) the level of application for setting Pillar 2 requirements should be aligned to the Pillar 1 approach; (ii) there should be no specific disclosure requirements under Pillar 2, other than the disclosure of the high quality liquid assets required to cover Pillar 2 risks which are part of the LCR disclosure requirements; (iii) it will use supervisory discretion, guided by a firm's outstanding debt or exposures, to assess liquidity risk linked with debt buyback and non-margined derivatives; and (iv) the assessment of intraday liquidity risk will be based on a firm's maximum net debits, stress testing framework and key characteristics, as well as the markets in which it operates.

The paper also sets out the PRA's initial approach to prime brokerage matched books and settlement failure risks. The PRA intends to consult on more specific proposals for these liquidity risks, using the feedback it receives on its proposed general approach. Responses to the proposals are due by August 12, 2016. The Pillar 2 requirements will only be implemented once all of the individual elements have been finalized by the PRA. The second consultation will also discuss a proposed approach to the timing and format of a transition path.

The consultation paper is available at:
http://www.bankofengland.co.uk/pra/Documents/publications/cp/2016/cp2116.pdf.

Conduct & Culture

UK Senior Manager and Certification Regime Amendments and Extension Final

On May 4, 2016, the Bank of England and Financial Services Act 2016 was passed by the UK Parliament. The Act includes amendments to the Senior Manager and Certification Regime and extends the SM&CR to all UK authorized firms. The amendments include removing the presumption of responsibility for a senior manager when a breach of regulatory provisions occurs in the area that he is responsible for, replacing it with a duty of responsibility. For a senior manager to be found guilty of misconduct by one of the UK regulators, the PRA and/or Financial Conduct Authority will need to prove that a senior manager did not take reasonable steps to prevent the contravention by his firm from occurring or continuing. In addition, the UK regulators are granted specific powers to take enforcement action against all non-executive directors of firms for their misconduct. The extension of the SM&CR follows from the recommendations of the Fair and Effective Markets Review, published in June 2015, that the regime should be extended to wholesale participants in the fixed income, currency and commodity markets.

Certain provisions of the Act came into effect immediately. It is not yet known when the extension to all UK authorized firms will occur but the UK regulators have mentioned 2018 in the past. On May 10, 2016, two pieces of secondary legislation in the form of an Order and Regulations brought the revised provisions published in the Bank of England and Financial Services Act 2016 on senior manager misconduct into force.

The Act is available at: http://www.legislation.gov.uk/ukpga/2016/14/pdfs/ukpga_20160014_en.pdf.

HM Treasury's press release is available at: https://www.gov.uk/government/news/bank-of-england-and-financial-services-bill-given-royal-assent and the Bank of England's press release is available at: http://www.bankofengland.co.uk/publications/Pages/news/2016/050.aspx.

The Order is available at: http://www.legislation.gov.uk/uksi/2016/568/pdfs/uksi_20160568_en.pdf and the Regulations are available at: http://www.legislation.gov.uk/uksi/2016/569/pdfs/uksi_20160569_en.pdf.

You may like to view our client note on Implementation Issues Arising from the revised UK SM&CR, available at: http://www.shearman.com/~/media/Files/NewsInsights/Publications/2015/11/Implementation-Issues-Arising-from-the-Revised-UK-Senior-Manager-and-Certification-Regime-FIA-100215.pdf.

Cyber Security

Chief Information Officer of US Federal Deposit Insurance Corporation Testifies Before the US House of Representatives on Information Security

On May 12, 2016, Chief Information Officer and Chief Privacy Officer of the US Federal Deposit Insurance Corporation, Lawrence Gross, testified before the Committee on Science, Space, & Technology of the U.S. House of Representatives' Subcommittee on Oversight. He discussed the FDIC's information security program and its ability to identify, analyze, report and remediate data security incidents. Gross noted that employees and contractors receive annual training to ensure they will report incidents when they have access to sensitive information. The FDIC also has a security incident response and escalation plan in place to ensure the systematic gathering and analysis of facts relevant to the incident, and an interdisciplinary team responsible for determining the appropriate course of action if there is an elevated risk of harm. After all facts have been gathered, the FDIC takes steps to mitigate the risk of harm and undertake appropriate reporting and notifications commensurate to the severity of the incident. Gross also detailed several remedial steps the FDIC is currently taking to further lower the risk of sensitive information being exposed.

Gross's testimony is available at: https://fdic.gov/news/news/speeches/spmay1216.html?source=govdelivery&utm_medium=email&utm_source=govdelivery.

Industry Associations Publish Principles on International Cyber Security, Data and Technology

On May 10, 2016, several industry associations jointly published a paper titled International Cybersecurity, Data and Technology Principles and urged the Financial Stability Board and the International Organization of Securities Commissions to take the Principles into account when developing policy and standards on cyber security, data and technology. The industry associations believe that cyber security for global financial institutions can only be addressed at an international level and are concerned that the rules of individual jurisdictions may lead to technology systems of global businesses becoming disintegrated, resulting in harm to competition, innovation and investors. The industry associations recommend that the Principles should be taken into account when any country creates laws, regulations, rules or standards on cyber security that could affect the framework of financial services firms that operate on a global basis. The industry associations are the European Banking Federation, the Global Financial Markets Association and the International Swaps and Derivatives Association.

The Principles are available at: http://www.ebf-fbe.eu/wp-content/uploads/2016/05/InternationalTechPrinciples.pdf.

Enforcement

US Deputy Attorney General Sally Yates Discusses Individual Accountability and Yates Memo

On May 10, 2016, US Deputy Attorney General Sally Yates discussed the history and implementation of the so-called "Yates Memo," a September 2015 policy statement issued by the US Department of Justice entitled "Individual Accountability for Corporate Wrongdoing." Yates stressed that the prosecution of individual employees and executives has always been a priority of the DOJ, and is essential to having a substantial impact on corporate culture. She highlighted the application of the policy to corporate actors in the financial services sector. However, determining which individuals are actually responsible for corporate misdeeds can be challenging in light of blurred authority lines and large amounts of documents that may be subject to privacy protection laws. Accordingly, Yates shared that the DOJ convened a group of Department lawyers to focus on ways the DOJ could overcome these challenges, and their discussions culminated in the issuance of the Yates Memo. While, pursuant to the Yates memo, companies are required to provide all facts about individual misconduct to qualify for any "cooperation credit," Yates emphasized that the scope of a company's investigation into such misconduct should be tailored to the scope of the wrongdoing, and that companies should continually turn over information as it becomes known during the course of their investigations. Yates further clarified that it is not necessary for companies to make judgments about individual culpability; instead, the DOJ wants facts about individual conduct. With respect to implementation, Yates noted that both the civil and the criminal sides of the DOJ have shifted their focus to individual culpability, and that the civil side in particular has shifted its focus from seeking out the largest penalties (often, from the largest corporate actor) to focus on determining and redressing the culpable conduct as a means of deterring corporate misconduct.

Deputy Attorney General Yates's remarks are available at: https://www.justice.gov/opa/speech/deputy-attorney-general-sally-q-yates-delivers-remarks-new-york-city-bar-association.

Financial Crime

US Treasury Announces Measures to Enhance Anti-Money Laundering, Bank Secrecy Act Compliance and Tax Evasion Rule Compliance

On May 6, 2016, the US Treasury Department put forth several measures to combat money laundering, corruption and tax evasion, in the wake of the so-called "Panama Papers" document leak. First, the US Treasury issued a final Customer Due Diligence Rule that for the first time requires all financial institutions to collect and verify the personal information of the individuals who own, control and profit from companies (i.e., the beneficial owners)when those companies open accounts. Specifically, the final rule requires all financial institutions to identify and verify the identity of the beneficial owners of companies opening accounts by obtaining the information on a standard certification form or by other means. The final rule also amends the anti-money laundering program requirements to include risk-based procedures for conducting ongoing customer due diligence to enable financial institutions to (1) understand the nature and purpose of customer relationships; and (2) conduct ongoing monitoring to identify and report suspicious transactions and maintain updated customer information. The final rule will be effective July 11, 2016, with a compliance date of May 11, 2018.

Treasury also announced that it would be sending new proposed beneficial ownership legislation to Congress that would require companies to know and report adequate and accurate beneficial ownership information at the time of a company's creation, so that the information can be made available to law enforcement agencies. Companies formed within the United States would be required to file beneficial ownership information with Treasury, and face penalties for non-compliance. In a letter to House Speaker Paul Ryan, Treasury Secretary Lew encouraged Congress to approve pending tax treaties and enact legislation that would require the United States to provide its international partners with the same information about US financial institutions as they are required to provide to the US Internal Revenue Service under the Foreign Account Tax Compliance Act. Finally, Treasury also announced proposed regulations related to foreign-owned disregarded entities, including foreign-owned single-member limited liability companies, that would require such entities to obtain an employer identification number with the Internal Revenue Service.

The press release is available at: https://www.treasury.gov/press-center/press-releases/Pages/jl0451.aspx.

The customer due diligence rule is available at: https://www.gpo.gov/fdsys/pkg/FR-2016-05-11/pdf/2016-10567.pdf.

Secretary Lew's letter to Speaker Ryan announcing its intention to propose beneficial ownership legislation is available at: https://www.treasury.gov/press-center/press-releases/Documents/Lew%20to%20Ryan%20on%20CDD.PDF.

Guilty Insider Dealers from Operation Tabernula Sentenced

On May 12, 2016, Mr. Martyn Dodgson and Mr. Andrew Hind were sentenced to imprisonment after having been found guilty of insider trading offences earlier this month by a UK court. Mr. Martyn Dodgson and Mr. Andrew Hind were found guilty of conspiring to commit insider dealing between November 2006 and March 2010 following a three-month trial in a case brought by the FCA. During the relevant period, Mr. Dodgson was employed by Morgan Stanley, Lehman Brothers and Deutsche Bank. Mr. Hind was a businessman, property developer and a qualified Chartered Accountant. Mr. Dodgson utilized his employment to secure information, both on transactions he personally worked on and through transaction in which his colleagues were involved. Mr. Hind acted as a "middle man" receiving information from Mr. Dodgson then dealing on behalf of Mr. Dodgson and himself. Mr. Dodgson and Mr. Hind used various strategies to conceal their activities, including using unregistered mobile phones, encrypted records and safety deposit boxes. Three other defendants, Andrew Harrison, Ben Anderson and Iraj Parvizi, who were accused of being party to the conspiracy, were acquitted. Sentencing will take place on a future date. The FCA confirmed that confiscation proceedings will also be pursued against the convicted individuals.

The convictions are a result of the FCA's largest insider dealing investigation, dubbed Operation Tabernula, which has also resulted in the conviction of Paul Milsom, Graeme Shelley and Julian Rifat.

Mr. Dodgson and Mr. Hind were sentenced to 4.5 years and 3.5 years imprisonment respectively. Mr. Dodgson's sentence is the longest ever handed down for an insider dealing case brought by the FCA. The trial judge, His Honour Judge Pegden, remarked that Mr. Dodgson's and Mr. Hind's offending was 'persistent, prolonged, deliberate, dishonest behavior'.

The FCA update is available at:

http://www.fca.org.uk/news/insider-dealers-sentenced-in-operation-tabernula-trial and the FCA's press release is available at: http://www.fca.org.uk/news/two-convicted-of-insider-dealing-in-operation-tabernula-trial.

You may like to view our client publication which is available at: http://www.shearman.com/~/media/Files/NewsInsights/Publications/2016/05/FCA-Obtains-Two-Criminal-Convictions-in-HighProfile-Insider-Dealing-Trial-FIIE-051116.pdf.

Ex-Financial Adviser Fined for Insider Dealing and Banned from Industry

On May 5, 2016, the FCA issued a final notice fining Mr. Mark Samuel Taylor for insider dealing and banning him from the UK financial services industry. On March 12, 2015, Mr. Taylor bought 5,582 shares in Ashcourt Rowan Plc for £15,012. Mr. Taylor's purchase was based on inside information he received through an email circulated in error by his employer, Towry Limited, where Mr. Taylor was employed as an experienced financial adviser. Mr. Taylor bought the shares using funds from his self-invested pension whilst aware he had acted on insider information. On the same day as Mr. Taylor's purchase, Towry Limited subsequently made a public announcement of its intention to acquire Ashcourt Rowan Plc with a revised offer. The announcement resulted in the share price of Ashcourt Rowan Plc rising by 26%, generating a profit of £3,498 for Mr. Taylor. The FCA considered that Mr. Taylor's conduct demonstrated a lack of honesty and integrity, and on that basis, found him to be in breach of the fit and proper person requirement to engage in any regulated activity in the UK financial services industry. Mr. Taylor's fine was initially £78,819. It was however reduced as a result of evidence that he was experiencing financial hardship and was further discounted given his cooperation in initially admitting to engaging in market abuse and voluntarily agreeing to settle in the early stages of the FCA's investigation.

The final notice is available at: http://www.fca.org.uk/static/documents/final-notices/mark-samuel-taylor.pdf.

Financial Market Infrastructure

US Federal Reserve Bank of New York Executive Vice President Discusses Resilience of Financial Market Infrastructures

On May 3, 2016, Executive Vice President and Head of the Wholesale Product Office at the US Federal Reserve Bank of New York, Richard Dzina, discussed the importance of improving the cyber resiliency of financial market infrastructures (FMIs) in light of escalating cyber threats with systemic consequences. Dzina cited the recent consultative report by the Committee on Payment and Market Infrastructures and the Board of IOSCOwhich provides guidance on cyber resilience for FMIs, including the expectation that their critical operations resume within a two-hour period following disruption. Heralding joint industry efforts as well as those taken by individual institutions, Dzina highlighted backup site (so-called "third site") capacity as a lynchpin to improving the resiliency of FMIs. Specifically, he recommended that FMIs invest in technologically diverse off-network third site solutions as a backstop to the measures they have in place to prevent against cyber-attacks. He stressed the importance of FMIs, particularly those at the epicenter of the financial system, continuously investing in improvements to resiliency and cybersecurity.
Dzina's speech is available at: https://www.newyorkfed.org/newsevents/speeches/2016/dzi160503.

International Organization of Securities Commissions Recommends the Development of Guidelines to Combat Issues Arising from the Impact of Storage and Delivery Infrastructure on Commodity Derivatives Market Pricing

On May 9, 2016, IOSCO published its final report on the impact of storage infrastructures on the integrity of the price formation process of physically-delivered commodity derivatives contracts traded on regulated exchanges. The report sets out findings and conclusions following research, an industry survey and a public roundtable. IOSCO concludes that the IOSCO Principles for the Regulation and Supervision of Commodity Derivatives Markets provide an adequate framework for implementing effective oversight, governance and operational controls of storage infrastructure. IOSCO does not recommend the creation of additional principles or revision of the existing principles. However, it does consider that it is necessary to develop good practice guidelines and enhance current accepted practices.

The report identifies several issues arising from storage infrastructure practices. First, there are issues related to the powers of financial regulators who have limited ability to detect emerging problems due to their limited scope of regulatory powers over warehouses. Different regulators are also often responsible for regulating different aspects of the market and storage, which may confuse market participants and possibly affect how quickly issues can be resolved. Regulatory uncertainty is also prevalent in cross-border scenarios where an exchange uses warehouses in a jurisdiction other than their home jurisdictions. Secondly, exchanges use different mechanisms to regulate physical delivery of commodities. IOSCO considers that terms setting out physical delivery requirements should be part of the contract specifications and not form part of the contracts between an exchange and a warehouse. This would give market participants greater certainty and give regulators more authority. Third, there is lack of transparency about the discounts and incentives offered by warehouses as well as warehouse operational parameters (e.g. stocks and queue length). The ability of exchanges and/or regulators to identify emerging issues is limited. Finally, conflicts of interest may arise where warehouse operators, derivative traders and exchange members belong to the same corporate parent.

IOSCO's report is available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD530.pdf and the IOSCO Principles are available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD358.pdf.

FinTech

US Commodity and Futures Trading Commission Commissioner Addresses Regulatory Issues Associated with Distributed Ledger Technology

On May 10, 2016, US Commodity and Futures Trading Commission Commissioner Christopher Giancarlo discussed the potential of distributed ledger technology, which he called "the biggest technological innovation in the financial services industry and financial market regulation in a generation or more." He noted the potential for distributed ledger technology to reduce dependence on third parties, mitigate centralized systemic risk and perform margin payments in the event of a counterparty default. In addition to the operational and transactional advantages that distributed ledger technology could bring to firms, Giancarlo suggested that it could also help financial market regulators in overseeing the broader financial market. As he has done in prior speeches, Giancarlo emphasized that in order for this technology to flourish, regulators must take a "do no harm" approach. He noted that regulations regarding distributed ledger technology are likely years away but suggested five steps for regulators to take to ensure that they "do no harm" to allow for distributed ledger technology innovation. Specifically, he recommended that the CFTC and other regulators designate teams to work collaboratively with FinTech companies, foster a regulatory environment that spurs innovation, participate directly in proof of concepts to ensure they understand the technology, work with innovators to determine how rules and regulations should be adopted and collaborate globally.

Commissioner Giancarlo's speech is available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo-15.

MiFID II

European Securities and Markets Authority Proposes Amended MiFIR List of Reportable Transactions

On May 4, 2016, ESMA published a Final Report on the revised draft Regulatory Technical Standard on transaction reporting under the Markets in Financial Instruments Regulation. ESMA is proposing amendments to the final draft RTS submitted to the European Commission on September 28, 2015. ESMA's final draft RTS included a non-definitive list of example transactions which would not attract the reporting obligation under MiFIR, but that list that was silent on acquisitions or disposals that were solely the result of a transfer of collateral. The amendment updates the list to include collateral transfers as a type of "transaction" that should not be reported under MiFID II. The definition of transaction in the RTS is based on the concepts of "acquisition" or "disposal" of a financial instrument. ESMA concluded that including transfers of collateral, as a reportable transaction, would lead to a significant increase in reported data that is not susceptible to market abuse which would serve only to burden the market. Details of collateral are already reported under EMIR and will be reported under the Securities Financing Transaction Regulation for some transactions. ESMA has submitted the Final Report to the Commission with the intention of having it taken into account in the context of the Commission's endorsement of the final draft RTS.

The update and final report is available at: https://www.esma.europa.eu/press-news/esma-news/esma-proposes-amend-draft-mifir-standard-transaction-reporting.

Recovery & Resolution

EU Technical Standards on Contents of a Business Reorganization Plan and Reporting on Implementation

On May 10, 2016, the European Commission adopted a Delegated Regulation outlining the regulatory technical standards on the elements of a business reorganization plan and the minimum contents for reporting progress in the implementation of the plan. The adopted Delegated Regulation will supplement the requirements set out in the Bank Recovery and Resolution Directive which requires a firm that has been bailed in to submit a plan to the resolution authority on how the firm, or parts of it, might be restored to long-term viability within a reasonable timescale.

The adopted RTS require a business reorganization plan to set out the firm's strategy for restoring viability, the projected financial performance of the firm and how it meet its prudential regulatory requirements on a going-forward basis and quarterly implementation milestones and performance indicators. The business reorganization plan must be also include information that will allow the national regulator and resolution authority to conduct a viability assessment of the proposed strategy for restoration.

BRRD also requires firms to submit progress reports to the resolution authority and national regulatory on the implementation of the plan. The RTS set out the required contents of a progress report. The report should outline the milestones that have been met, the measures that have been realized and the actual impact of measures taken compared with those envisaged as well as provide a performance comparison of the institution with the forecast in the business reorganization plan. If the firm has failed to meet milestones or has been delayed in doing so, the report should include reasons and proposals to remedy shortfalls. The report should also refer to any issues arising in the execution of the plan that may prevent restoration to long-term viability, upcoming measures and milestones and, if necessary, proposals for adjustments to milestones or performance indicators.

The RTS must still be considered by the European Parliament and the Council of the European Union before they can become final.

The RTS is available at: https://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2665-EN-F1-1.PDF.

Resolution Stay Jurisdictional Modular Protocol Launched

On May 5, 2016, ISDA launched the Resolution Stay Jurisdictional Modular Protocol and the UK (PRA Rule) Jurisdictional Module. Certain jurisdictions require banks and investment firms to include clauses in certain contracts with non-EU counterparties by which the counterparty agrees to recognize the powers of the firm’s national regulator to impose a temporary stay on the exercise of early termination rights. The new protocol seeks to help banks comply with new requirements. Many jurisdictions have implemented national regimes on the recovery and resolution of banks and investment firms. However, whether the actions of a national regulator in relation to a failing or failed firm would be recognized by regulators, authorities and courts in other jurisdictions is uncertain and may require contractual support in some countries. Without a global statutory framework in place, the Financial Stability Board recommends jurisdictions to implement laws to ensure that their powers will be recognized on a contractual basis. The UK (PRA Rule) Jurisdictional Module is intended to assist compliance with the UK’s requirements on recognition of temporary stays.

The Resolution Stay Jurisdictional Modular Protocol and the UK (PRA Rule) Jurisdictional Module is available at: http://www2.isda.org/functional-areas/protocol-management/protocol/24; and ISDA’s press announcement is available at: http://www2.isda.org/news/isda-launches-resolution-stay-jurisdictional-modular-protocol.

People

New Board at the International Organization of Securities Commissions

On May 12, 2016, IOSCO announced that Mr. Ashley Alder had been appointed as the new Chair of the IOSCO board. Mr. Adler replaces Mr. Greg Medcraft, who has been chair for three years. Mr. Jean-Paul Servais will succeed Mr. Alder in his current position of Vice Chair. Mr. Alder is also the Chief Executive Officer of the Securities and Futures Commission (SFC) Hong Kong.

The announcement is available at: http://www.iosco.org/news/pdf/IOSCONEWS427.pdf.

Upcoming Events

May 18, 2016: US House Financial Services Committee hearing entitled "Examining the CFPB's Proposed Rulemaking on Arbitration: Is it in the Public Interest and for the Protection of Consumers?"

May 18, 2016: US House Financial Services Committee hearing entitled "Legislative Proposals to Enhance Capital Formation, Transparency, and Regulatory Accountability"

Upcoming Consultation Deadlines

May 18, 2016: FCA Call for Input on Retained Provisions of the Consumer Credit Act

May 20, 2016: ESMA Consultation on Guidelines for Information on Commodity and Spot Markets under the Market Abuse Regulation

May 26, 2016: FDIC Notice of Proposed Rulemaking on Recordkeeping for Timely Deposit Insurance Determination

June 2, 2016: UK Government, Consultation on proposed amendments to anti-money laundering and counter-terrorist finance legislation

June 2, 2016: HM Treasury Consultation on UK Government's proposed secondary annuities market due to be introduced in April 2017

June 3, 2016: Federal Reserve Board Notice of Proposed Rulemaking on Single-Counterparty Credit Limits for Domestic and Foreign Bank Holding Companies

June 3, 2016: Federal Reserve Board Notice for Proposed Agency Information Collection Activities regarding New Data Items for Regulatory Reporting by Foreign Banking Organizations

June 3, 2016: Basel Committee on Banking Supervision Consultation on Standard Measurement Approach for Operational Risk

June 3, 2016: PRA Consultation on Risk-Based Levies for the Financial Services Compensation Scheme Deposit Class

June 10, 2016: Basel Committee Proposal for a Revised Pillar 3 Disclosure Framework

June 14, 2016: European Commission Consultation on Harmonizing EU Insolvency Regimes Under its Capital Markets Union Action Plan

June 21, 2016: FCA Consultation on Proposed Rules and Guidance for the Secondary Annuity Market due to start in April 2017

June 22, 2016: EBA Consultation on Changes to Calculation of Interest Rate Risk on Capital Requirements

June 29, 2016: PRA Consultation on Underwriting Standards for Buy-to-Let Mortgage Contracts

July 6, 2016: Basel Committee on Banking Supervision, consultation paper on proposed revisions to the Basel III leverage ratio framework

July 6, 2016: EBA, Consultation on amendments to the RTS for determining proxy spread and the specification of a limited number of smaller portfolios for credit valuation adjustment risk under the Capital Requirements Regulation

July 13, 2016: FCA Report on Investment and Corporate Banking Strategy

July 14, 2016: FCA and PRA Consultation on Proposed Implementation of the Enforcement Review and the Green Report

July 15, 2016: Basel Committee Consultation on Guidelines for Prudential Treatment of Problem Assets

July 22, 2016: US Federal Reserve Board, OCC, FDIC, NCUA, FHFA and SEC Notice of Proposed Rulemaking on Incentive-Based Compensation Restrictions

July 29, 2016: PRA, proposals on future reporting of balance sheet, statement of profit and loss and forecast capital data

August 4, 2016: EBA, risks and benefits associated with the innovative uses of consumer data by financial institutions

August 5, 2016: US Federal Reserve Board, OCC and FDIC Notice of Proposed Rulemaking to Establish the Net Stable Funding Ratio

August 5, 2016: US Federal Reserve Board Notice of Proposed Rulemaking on Restrictions on Qualified Financial Contracts of Systemically Important US Banking Organizations and the US Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions

August 11, 2016: EBA, Consultation on LCR Disclosure and Disclosure of Liquidity Risk Management

August 12, 2016: PRA, Consultation on Pillar 2 Liquidity Risk Requirements

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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