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FINANCIAL REGULATORY DEVELOPMENTS FOCUS

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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.

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

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Bank Prudential Regulation & Regulatory Capital

US Office of the Comptroller of the Currency Releases Updated Supervision Booklets

On June 28, 2018, the U.S. Office of the Comptroller of the Currency announced updates to a number of supervision booklets, including the "Bank Supervision Process," "Community Bank Supervision," "Compliance Management Systems" and "Large Bank Supervision" booklets of the Comptroller's Handbook, and the "Federal Branches and Agencies Supervision" booklet. The updated booklets replace previously issued booklets of the same titles. The OCC also provided a table of previously issued bulletins and publications that have been rescinded and incorporated into the updated booklets. At a high level, the revisions and updates clarify the applicability of the booklets for financial institutions of differing size; add content with respect to asset management, including assessing Bank Secrecy Act, anti-money laundering and Office of Foreign Assets Control compliance; incorporate aspects of the Dodd-Frank Act; make technical corrections, including clarified terminology and to reflect the integration of the Office of Thrift Supervision into the OCC; include revised concepts and references; and incorporate references to OCC issuances published since each booklet's last publication date.

The full text of the OCC press release and revised booklets are available at: https://www.occ.treas.gov/news-issuances/bulletins/2018/bulletin-2018-18.html.

US Federal Reserve Vice Chairman for Supervision Discusses the Promotion of Global Financial Stability

On June 27, 2018, U.S. Board of Governors of the Federal Reserve System Vice Chairman for Supervision, Randal Quarles, discussed the importance of the promotion of global financial stability at the Utah Bankers Association 110th Annual Convention. Vice Chairman Quarles began by discussing financial stability in the United States, noting that the implementation of post-financial crisis reform is largely complete and is now in the process of being reviewed and revised to promote efficiency and efficacy. Vice Chairman Quarles also noted how this review and revision process is easing the regulatory burden on community and regional banks, through reforms such as the passage of the Economic Growth, Regulatory Relief and Consumer Protection Act, the Bank Exams Tailored to Risk program and the implementation of a new streamlined Call Report form in 2017. With respect to global financial stability, Vice Chairman Quarles discussed the role of the Financial Stability Board, explaining that the FSB helps to improve access to information on an international scale and promote minimum standards in areas such as resolution planning. Vice Chairman Quarles also highlighted that while the FSB may set international regulatory standards, it has no enforcement powers and no legal authority to direct its members to act. Instead, the FSB promotes effective dialogue by functioning by consensus, which allows international stakeholders to have meaningful input in the decisions that are made.

The full text of Vice Chairman Quarles's speech is available at: https://www.federalreserve.gov/newsevents/speech/quarles20180627a.htm.

EU Draft Amended Technical Standards on Benchmarking of Internal Models

On June 29, 2018, the European Banking Authority published an amended draft Implementing Technical Standards specifying the benchmarking portfolios, templates and definitions to be used as part of the annual benchmarking exercise by those institutions that use internal approaches for market and credit risk under the EU Capital Requirements Directive. The EBA consulted on proposed changes to the ITS in Q4 2017 and Q1 2018.

The amended ITS include all the portfolios that will be used for the 2019 benchmarking exercise, provided that the amended ITS are adopted by the European Commission. For market risk benchmarking, major changes have been made to the portfolios, including the introduction of a new set of portfolios comprising vanilla instruments. Minor changes have been made to the credit risk portfolios including changes to the information requested from firms.

Regarding the 2018 benchmarking exercise, the EBA has confirmed that firms do not have to resubmit the same data as a result of the difference between the submission dates in the draft ITS published by the EBA and the final ITS published on May 18, 2018 in the Official Journal of the European Union.

The amended ITS is available at: http://www.eba.europa.eu/-/eba-publishes-updated-its-package-for-2019-benchmarking-exercise?_sm_au_=iVVM5DMRPQTJQZTQ and details of the EBA's consultation on amending the ITS is available at: https://finreg.shearman.com/european-banking-authority-consults-on-amended-te.

UK Prudential Regulator Confirms Changes to Large Exposures Framework

On June 28, 2018, following a consultation in October 2017 which closed on January 4, 2018, the U.K. Prudential Regulation Authority published a Policy Statement on changes to its large exposures framework.

The Policy Statement sets out the PRA's feedback on the responses received to its consultation. Respondents were largely supportive of the proposals. The PRA is implementing its proposals largely as consulted on, with only minor changes. The Policy Statement outlines the changes as follows:

- Changes to the relevant part of the PRA Rulebook on large exposures and regulatory reporting—the text of the changes is set out in a PRA Rulebook Instrument, "CRR Firms: Large Exposures Amendment Instrument."
- An update to the PRA's supervisory statement on large exposures (SS16/13) to reflect the PRA's expectations on the resolution exemption and to provide additional guidance to firms on Core U.K. Group and Non-core Large Exposures Group permissions.
- An update to the PRA's supervisory statement, Guidelines for completing regulatory reports (SS34/15), to remove the requirement to submit the U.K. integrated groups—large exposures data item (FSA018).

The Policy Statement also contains a simplified worked example of the application of the large exposures limits at the level of the U.K. consolidated group when the firm has a NCLEG permission.

The changes to the rules and updates to the supervisory statements took effect on June 29, 2018.

The Policy Statement (PRA PS 14/18) is available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2018/ps1418.pdf, the PRA Rulebook Instrument: CRR Firms: Large Exposures Amendment Instrument 2018 (PRA 2018/14) is available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2018/ps1418app1.pdf, the update to Supervisory Statement SS16/13: Large Exposures is available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2013/large-exposures-ss, the update to Supervisory Statement SS34/15: Guidelines for completing regulatory reports is available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/supervisory-statement/2018/ss3415update-june-2018.pdf and details of the October 2017 consultation are available at: https://finreg.shearman.com/uk-prudential-regulation-authority-consults-on-ch.

Brexit for Financial Services

European Banking Authority Warns Financial Institutions to Prepare for a Hard Brexit

On June 25, 2018, the EBA published an Opinion on preparations for the withdrawal of the U.K. from the EU. The Opinion is addressed to EU national regulators and regulators in the European Free Trade Area States (Norway, Liechtenstein and Iceland), the European Central Bank and the Single Resolution Board. The

Opinion concerns the activities of financial institutions in the context of preparing for the U.K.'s withdrawal. Financial Institutions comprise credit institutions, investment firms, payment service providers, electronic money institutions, creditors and credit intermediaries.

The purpose of the Opinion is to encourage national regulators to ensure that financial institutions are adequately considering the risks that arise from the possible departure of the U.K. from the EU in March 2019 without a ratified withdrawal agreement in place (a so-called "hard" Brexit). The EBA also seeks to ensure that national regulators draw the attention of financial institutions to their consumer protection obligations should that eventuality occur.

The EBA has been monitoring the level of contingency planning by firms through its engagement with national regulators. In its view, preparations by firms are inadequate. Political agreement was reached in March 2018 on an agreed "transition" or "implementation" period that would run until December 31, 2020. However, the EBA warns that this does not provide any legal certainty until the withdrawal agreement is ratified. The U.K. will depart the EU without a transitional period on March 30, 2019 if the withdrawal agreement is not ratified by that time. In light of this risk, the EBA urges firms to pursue any necessary mitigating actions without delay.

The Opinion goes on to list a series of issues that national regulators should ensure financial institutions consider when assessing the implications of the U.K. withdrawal for their business. These include identifying relevant risk channels (direct financial exposures, existing contracts, reliance on financial market infrastructures, storage and transfer or data, reliance on funding markets), the implications for capital planning, the need to obtain any necessary regulatory permissions, the implications for their booking models and outsourcing arrangements, the need to engage with affected clients, the availability of financial market infrastructure and the implications for recovery and resolution planning. Notably, the EBA is empowered to issue advice or determinations on several equivalency regimes which would definitively address a number of the risk issues which it now highlights, but the EBA has taken no steps to provide such assurances. The EBA appears not to consider that it has been empowered politically to take such steps, even on basic issues such as group capital equivalence.

The Opinion also stresses the need for firms to consider their obligations to existing and prospective customers. It sets out a list of minimum information that national regulators should ensure firms send, no later than the end of 2018, to customers whose contracts or services might be affected. It also states that national regulators should require firms to inform them of their customer communications and to provide them with the text of those communications on request.

The Opinion (EBA/Op/2018/05) is available at: http://www.eba.europa.eu/documents/10180/2137845/EBA+Opinion+on+Brexit+preparations+%28EBA-Op-2018-05%29.pdf. You may like to view our Client Note on Brexit Contingency Planning, available at: https://www.shearman.com/-/media/Files/Perspectives/2018/03/Brexit-Contingency-Planning-in-Financial-Services-Have-All-The-Angles-Been-Considered-FIAFR-03162018.pdf?la=en&hash=95E2E2C69AE80253EA13AD20312443FBBB36C0FE.

UK Government and Regulators' Approach to Onshoring Financial Services Legislation for Brexit

On June 27, 2018, following the enactment of the European Union (Withdrawal) Act 2018, HM Treasury set out its approach to "onshoring" EU financial services legislation under the Act. The Bank of England, the Financial Conduct Authority and the Payment Systems Regulator have each also issued statements on their respective roles in preparing for the U.K.'s withdrawal from the EU.

The U.K. and the EU have, in principle, agreed the terms of a transitional, or implementation, period to run from March 29, 2019 (the date of the U.K. exit) to December 31, 2020. During that implementation period, the U.K. would remain a member of the EU's single market in financial services. Passporting and other relevant EU frameworks would remain available, allowing U.K. and EU firms, funds and trading venues to continue to provide services cross-border or via branches, U.K. financial market infrastructures, such as CCPs, to continue to provide services in the EEA and EEA and third-country financial market infrastructures to continue to provide services in the U.K.

The European Union (Withdrawal) Act 2018 converts EU law as it stands at the moment of exit into domestic law before the U.K. leaves the EU (this is referred to as onshoring). The EUWA also empowers ministers to make statutory instruments to prevent, remedy or mitigate any failure of EU law to operate effectively or any other "deficiency" in retained EU law. The statutory instruments will not themselves make any policy changes and the power to create them will fall away two years after exit day. HM Treasury has conducted a thorough review to identify deficiencies that will require statutory instruments to be laid under the EUWA. Examples of deficiencies include provisions in retained EU law that would become redundant, such as references to the relationship between EU and member state supervisory bodies, and provisions that refer to functions carried out by EU authorities that would no longer apply on the U.K.'s exit.

HM Treasury intends to sub-delegate powers to the relevant U.K. regulators to address deficiencies in the U.K. regulatory rulebooks and to task the regulators with making any necessary amendments to, and subsequently maintaining, the Regulatory Technical Standards and ITS which comprise "level 2" of the EU legislation that will be onshored. These RTS and ITS sit under the "level 1" EU legislation and do not set any policy direction. Instead they provide technical detail on how the level 1 requirements must be met. HM Treasury issued draft legislation on the sub-delegation of powers in April 2018, the Financial Regulators' Powers (Technical Standards) (Amendment etc.)(EU Exit) Regulations 2018. Among other things, this draft legislation provides for HM Treasury approval to be obtained for changes to RTS/ITS and for the regulators to produce an annual report to HM Treasury showing how they have exercised their sub-delegated powers under EUWA.

On Brexit, U.K. bodies will also need to take over functions that are carried out by EU bodies. HM Treasury is allocating those functions as part of its onshoring work. HM Treasury intends that the FCA will be empowered to regulate credit rating agencies and trade repositories, a function currently carried out by the European Securities and markets Authority. The BoE will take over ESMA's current functions and powers in relation to non-U.K. CCPs and non-U.K. CSDs. A division of powers between U.K. regulators has already been proposed in the Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018 and accompanying explanatory note.

The statement issued by HM Treasury states that firms should continue to plan for Brexit on the assumption that an implementation period will be in place from March 29, 2019. However, given that the agreed terms of the implementation period will not be binding unless and until there is finalization of a Withdrawal Agreement between the EU and the U.K., HM Treasury must also plan for a "no deal" scenario, whereby the U.K. becomes a third country on exit day. HM Treasury's approach to drafting the necessary onshoring legislation is to ensure continuity and certainty, and to protect financial stability, by readying the U.K. framework for a no deal scenario, with legislation that can take effect either on exit day or at a later date if the U.K. enters the implementation period. The U.K. will also introduce a Temporary Permissions Regime. Announced in December 2017, the proposed TPR will allow EEA firms that would lose their passporting rights on a "no deal" Brexit to continue to operate in the U.K. for a time-limited period, which would provide them with time to seek U.K. authorization for their activities.

HM Treasury and the regulators have outlined their plans for consultation as follows:

- Over the summer 2018, HM Treasury will issue a number of statutory instruments. These statutory instruments will relate to the TPR, the TPR for CCPs and to the sub-delegated powers for the regulators on the RTS/ITS and rulebook amendments. The first set of draft statutory instruments to correct deficiencies in retained EU law will also be published, dealing with prudential regulation and capital markets issues.
- In autumn 2018, the FCA will issue a consultation paper on how it plans to amend its Handbook and the RTS/ITS for which it has responsibility. The BoE also expects to consult in autumn on the RTS/ITS for which it has responsibility. The PSR is the main U.K. regulator under the Interchange Fees Regulation ((EU) 2015/751) and is also expected to consult on RTS/ITS under that regulation.
- From autumn 2018 and into early 2019, HM treasury will issue further groups of statutory instruments to correct deficiencies in retained EU law. The FCA will also consult on rules that will apply to EEA firms in the TPR and will publish information for EU entities that currently access or do business in the U.K. without using passporting rights.

HM Treasury's Statement is available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/720298/HM_Treasury_s_approach_to_financial_services_legislation_under_the_European_Union__Withdrawal__Act.pdf, the Bank of England Press Release is available at: https://www.bankofengland.co.uk/-/media/boe/files/news/2018/june/boes-approach-to-financial-services-legislation-under-the-eu-withdrawal-act.pdf, the FCA statement is available at: https://www.fca.org.uk/news/statements/fca-role-preparing-for-brexit, the PSR's Statement is available at: https://www.psr.org.uk/psr-publications/news-announcements/PSR-approach-financial-services-legislation-under-EU-withdrawal-act, the draft Financial Regulators' Powers (Technical Standards)(Amendment etc.) (EU Exit) Regulations 2018 are available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/701834/draft_Financial_Regulators__Powers__Technical_Standards__Regulations.pdf and the HM Treasury's December 2017 announcement is available at: https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2017-12-20/HCWS382/, the U.K. Regulators' announcements on their approaches are available at: https://finreg.shearman.com/uk-government-and-regulators-set-out-approach-to-.

UK Brexit Legislation Receives Royal Assent

On June 26, 2018, the EU (Withdrawal) Bill received Royal Assent from Her Majesty the Queen and has become an Act of Parliament, the EU (Withdrawal) Act 2018. The Act, which was also formerly referred to as the Great Repeal Bill, is necessary to ensure that the U.K.'s laws continue to operate from the day the U.K. exits the EU.

From the date of the U.K.'s exit from the EU, the Act will (i) end the supremacy of EU law in U.K. law by repealing the European Communities Act 1972; (ii) convert EU law as it stands at the moment of exit into domestic law before the U.K. leaves the EU; and (iii) maintain the current scope of devolved decision making powers in areas currently governed by EU law.

The Act also creates powers to make secondary legislation, including temporary powers to enable corrections to be made to the laws that would otherwise no longer operate appropriately once the U.K. has left the EU and to implement the withdrawal agreement under Article 50 of the Treaty on European Union. The U.K. Government will now start work to begin laying before Parliament the expected 800 pieces of secondary legislation that will be required to prepare the U.K.'s statute book for EU withdrawal.

According to the Institute for Government, the two Houses of Parliament spent over 272 hours debating the original bill. The U.K. Government avoided defeats in the House of Commons by conceding on a number of issues. The Government rejected a number of high profile proposed amendments such as a proposed amendment to give Parliament power to approve a mandate for negotiations on the U.K.'s future relationship with the EU. The Government accepted one and made concessions on eight of the 15 amendments to the bill that were tabled by the House of Lords. The final Act differs from the originally tabled bill including in the following key areas:

- Customs union—the Government must lay a statement before Parliament before October 2018, outlining steps taken to negotiate an agreement for the U.K. to participate in a customs arrangement with the EU.
- Enhanced scrutiny—secondary legislation used to amend certain retained EU law will be subject to the affirmative scrutiny procedure, which means that they will need to be approved by both Houses of Parliament.
- Challenges to retained EU law—legal challenges to domestic law if it fails to comply with the general principles of EU law will be allowed for three years after exit day, on the basis that the Act transfers general principles of EU law into domestic law as long as they are recognized by the European Court of Justice before exit day.
- A "meaningful vote" for Parliament on the Withdrawal Agreement – Parliament will vote to approve the proposed Withdrawal Agreement and, if it does not approve it, a minister will make a statement setting out how the Government "proposes to proceed" within 28 days. The House of Commons would have a vote on a motion in neutral terms to consider that ministerial statement.
- Northern Ireland—an amendment by way of a new clause referring to the North-South co-operation in the Good Friday Agreement and reducing the list of new border arrangements, subject to an agreement between the U.K. and the EU (rather than the U.K. and Ireland).
- ECJ judgments—a set of amendments give greater guidance to U.K. courts as to when they should refer to ECJ judgments after exit day. The original wording provided that a U.K. court should refer to ECJ judgments "if it considers it appropriate." This has been amended to say that courts should refer to ECJ judgments when "relevant."
- Status of retained EU law—a new clause has been added clarifying the status of retained EU law after exit day and how it should be amended after exit day.
- Scope of delegated powers—the Government supported an amendment tabled by the House of Lords to remove the ability of ministers to amend the Act itself using secondary legislation.
- Removal of clause 6—it became clear to the Government as the bill progressed through parliament that it would be unnecessary to retain clause 6, which gave ministers the power to use secondary legislation to amend U.K. law so that the U.K. would continue to comply with international obligations after exit from the EU.
- Devolution—amendments give U.K. ministers power to place temporary restrictions on the devolved administrations' ability to legislate in certain devolved policy areas returning from the EU, while U.K.-wide frameworks are legislated.

The European Union (Withdrawal) Act 2018 (2018 c.16) is available at: http://www.legislation.gov.uk/ukpga/2018/16/contents/enacted/data.htm, the explanatory notes to the Act are available at: http://www.legislation.gov.uk/ukpga/2018/16/pdfs/ukpgaen_20180016_en.pdf, our Client Note on the European Union (Withdrawal) Bill is available at: https://www.shearman.com/perspectives/2017/07/brexit-the-great-repeal-bill.

Competition

UK Regulator Provides Update on Its Retail Banking Business Model Review

On June 27, 2018, the U.K. FCA published a Progress Report on its Strategic Review of Retail Banking Business Models. The FCA launched the Review in April 2017 and published a purpose and scope document in October 2017. The FCA is conducting the Review to gain a picture of how profits are generated by the sector, of the relative competitive advantages and disadvantages of different business models and of barriers to entry and expansion. The Review covers retail banking services to personal and small business customers. It focuses on the products and services that are used on a regular basis by large numbers of consumers and small businesses. This includes current accounts, savings products, mortgages, personal loans, credit cards and business finance.

The FCA explains that its early analysis indicates that a key component of the competitive advantage enjoyed by retail banks to date has been the combination of personal current accounts and large branch networks. This combination has brought a number of benefits including a funding cost advantage (from personal current accounts paying zero interest or lower interest than other providers), significant additional income from fees and charges on personal current accounts (including overdrafts), the opportunity to cross-sell lending products to personal current account holders and the ability to cross-sell business accounts and associated business savings balances.

The FCA's work is ongoing. In the Progress Report, the FCA explains that it has not yet explored all relevant factors. It continues to develop a fuller picture of the drivers of return on equity and an understanding of the impact of branch closures on different consumer types. The FCA highlights a number of areas where it plans further engagement with banks and building societies to further its analysis. A particular focus of the next stage of the review will be the nature of the customer base and costs of retail banking.

Some commentators have expressed concerns that the tone and findings of the Progress Report imply that the regulators will take steps that result in an end for free-of-charge retail banking in the U.K.

The FCA invites responses to the Progress Report's findings by September 7, 2018. The FCA will also engage directly with banks to discuss the issues it has raised.

The Progress Report is available at: https://www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-progress-report.pdf and details of the purpose and scope of the review are available at: https://finreg.shearman.com/uk-regulator-outlines-scope-of-retail-banking-bus.

Derivatives

US Commodity Futures Trading Commission and the Securities and Exchange Commission Approve New Arrangements to Harmonize Title VII Rulemakings

On June 28, 2018, the U.S. Commodity Futures Trading Commission and the Securities and Exchange Commission approved a new Memorandum of Understanding between the two agencies. The MOU, which updates and enhances an MOU approved by the agencies in 2008, is aimed at fostering cooperation and information sharing in order to harmonize joint rulemakings mandated under Title VII of Dodd-Frank, which governs the regulation of swaps and security-based swaps.

The MOU outlines several measures intended to increase coordination. These include holding inter-agency meetings and consultations to enhance coordination and cooperation, sharing information relating to firms registered with both agencies and specific incidents that are of common regulatory interest to both agencies, and informing the other agency in advance of developments that may impact its regulatory interests.

CFTC Chairman J. Christopher Giancarlo said the MOU will enhance the agencies' "oversight efforts and reduce unnecessary complexity, and lessen costs on both regulators and market participants," and SEC Chairman Jay Clayton added that the agreement will support a "coherent and coordinated approach to regulation."

The MOU will become effective on the date of its signing and will remain effective unless terminated by either agency. Revisions and modifications may be made upon agreement or as required by changes in law.

The joint press release is available at: https://www.cftc.gov/PressRoom/PressReleases/7745-18 and the MOU is available at: https://www.cftc.gov/sites/default/files/2018-06/CFTC_MOU_InformationSharing062818.pdf.

US Commodity Futures Trading Commission Approves Proposed Amendments to Self-Regulatory Organization Surveillance Programs for Futures Commission Merchants

On June 28, 2018, the CFTC proposed to simplify its standards for a self-regulatory organization's financial surveillance program for futures commission merchants. The proposed amendments result from the CFTC's Project KISS initiative to simplify and modernize the Commission's regulations.

Under CFTC Regulation 1.52, a third-party examinations expert is required to evaluate an SRO's FCM supervisory program and the application of the program at least once every three years. The proposed amendments would narrow the scope of this evaluation to only consider whether the SRO's FCM examination standards are consistent with auditing standards issued by the Public Company Accounting Oversight Board. The proposal would also reduce the frequency of reviews by an examination expert, to once every five years or after the issuance of new or amended audit standards by the PCAOB that require material changes to the SRO's FCM examination standards.

Comments on the proposed amendments are due September 4, 2018.

The CFTC's press release is available at: https://www.cftc.gov/PressRoom/PressReleases/7746-18 and the proposed amendments are available at: https://www.cftc.gov/sites/default/files/2018-07/2018-14272a.pdf.

FinTech

UK Prudential Regulator Sets Out Expectations on Firms' Exposures to Crypto-Assets

On June 28, 2018, the U.K. PRA published a "Dear CEO" letter, addressed to the Chief Executive Officers of banks, insurance companies and designated investment firms. The purpose of the letter is to remind firms of their relevant obligations under the PRA rules and to communicate the PRA's expectations regarding firms' exposures to crypto-assets.

Crypto-assets have exhibited high price volatility and relative illiquidity and may also be vulnerable to fraud and manipulation, which raises concerns about potential misconduct and poses issues for market integrity. The PRA's letter does not define crypto-assets, but the FCA uses this term to refer to any publicly available electronic medium of exchange that features a distributed ledger and a decentralized system for exchange. The FCA recently published a "Dear CEO" letter outlining best practice for firms in handling the financial crime risks that crypto-assets can pose.

The PRA letter reminds firms that they have responsibilities under the PRA's Fundamental Rules. Particularly relevant in the context of crypto-assets are FR 3 (to act in a prudent manner), FR 5 (to have effective risk strategies and risk management systems) and FR 7 (to deal with regulators in an open and co-operative way, and disclose appropriately anything relating to your firm of which the PRA would reasonably expect notice). The letter then goes on to outline risk strategies and risk management systems that the PRA considers most appropriate for crypto-assets. These are:

- The risks of this new, evolving asset class should be considered at the level of the board and the highest levels of executive management. In the case of insurance firms, this should also include an individual appointed to an appropriate Senior (Insurance) Management Function, who should be involved in review and sign-off on the risk assessment framework for any planned exposure to crypto-assets.
- Firms should ensure, within their remuneration policies and practices, that incentives for engaging in crypto-assets-related activity do not encourage excessive risk-taking.

- Firms' risk management approach—which includes not only financial risk but also cyber risk, wider operational risk and reputational risk—should be commensurate to the risks of crypto-assets. The approach should include ensuring the firm has access to appropriate, relevant expertise to assess any risks stemming from exposure to these technically complex assets. Extensive due diligence should be conducted before taking on any crypto-asset exposure and appropriate safeguards should be maintained against the related risks.

The letter confirms the PRA's expectations around classifying crypto-assets for prudential purposes. The PRA explains that, although classification will depend on the precise features of the assets, it does not generally expect crypto-assets to be classified as currency for prudential purposes.

The letter requests that, where relevant, firms set out their consideration of risks relating to crypto-asset exposures in their internal capital adequacy assessment process or their own risk and solvency assessment. The letter also requests that firms keep their PRA supervisory contact informed of any planned crypto-asset exposure or activity, together with an assessment of the associated risks.

Finally, the PRA states that it will communicate any supervisory or policy updates on the prudential treatment of crypto-assets, including through Pillar 2 for banks, if it deems it necessary as a result of ongoing discussions among authorities internationally.

The PRA's Dear CEO letter is available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2018/existing-or-planned-exposure-to-crypto-assets.pdf and the FCA's Dear CEO letter is available at: https://finreg.shearman.com/uk-financial-conduct-authority-sets-out-good-prac.

Recovery & Resolution

US Federal Reserve Board and US Federal Deposit Insurance Corporation Seek Comment on 2019 Resolution Plan Guidance

On June 29, 2018, the U.S. Federal Reserve Board and U.S. Federal Deposit Insurance Corporation published revised resolution plan (or "living wills") guidance for the eight largest and most complex U.S. banking institutions. The proposed guidance would be applicable to resolution plans submitted beginning in 2019. The proposed guidance is largely based upon, and consistent with, prior guidance issued by the Federal Reserve Board and FDIC in 2016—through the publication of *Guidance for 2017 §165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Resolution Plans in July 2015*—and has been informed by, and updated as a result of, Federal Reserve Board and FDIC review of recent resolution plan submissions by these institutions. Consistent with prior guidance published by the Federal Reserve Board and FDIC, the proposed guidance is organized into six substantive areas: (1) Capital; (2) Liquidity; (3) Governance Mechanisms; (4) Operational; (5) Legal Entity Rationalization and Separability; and (6) Derivatives and Trading Activities. The proposed guidance includes updates to the Derivatives and Trading Activities and Operational: Payment, Clearing, and Settlement Activities Sections, and makes other clarifying changes. The changes and updates are intended, in part, to help streamline submissions by these institutions and to provide additional clarity with respect to the process. Comments to the proposed guidance will be due 60 days from its publication in the Federal Register.

The full text of the proposal is available at: https://www.fdic.gov/news/news/press/2018/pr18040.pdf.

US Federal Reserve Board Releases 2018 CCAR Results

On June 28, 2018, the Federal Reserve Board announced the results of this year's Comprehensive Capital Analysis and Review process. This year, 35 financial institutions participated in the CCAR process. The CCAR process consists of a quantitative assessment, which evaluates an institution's capital adequacy and planned capital distributions against its ability to continue operating and lending throughout times of economic and financial market stress. In addition to the quantitative analysis, institutions that are designated "large and complex firms" or supervised by the Large Institution Supervision Coordinating Committee are subject to a qualitative assessment, which evaluates the reliability of each institution's analyses and other processes for capital planning. Of the 35 institutions that participated, 18 were subject to both quantitative and qualitative assessments, while the remaining 17 were only subject to the quantitative assessment. In connection with the CCAR process, the Federal Reserve Board objected to the capital plan of one institution due to qualitative concerns. Two institutions were issued a conditional no-objection to their capital plans and will be required to maintain their capital distributions at the levels paid by these institutions in recent years. A third institution was issued a conditional no-objection to its capital plan, subject to the institution "taking certain steps regarding the management and analysis of its counterparty exposures under stress."

The full text of the 2018 CCAR results is available at: https://www.federalreserve.gov/publications/files/2018-ccar-assessment-framework-results-20180628.pdf.

Securities

European Money Markets Institute Confirms Certain Changes for Euribor

On June 28, 2018, the European Money Markets Institute published a feedback summary report on its March 2018 consultation on a hybrid determination methodology for the Euro Interbank Offered Rate (Euribor). EMMI is the administrator for Euribor, a major euro interest reference rate for unsecured interbank short-term lending and borrowing. Euribor was classed as a critical benchmark of systemic importance for financial stability by the European Commission in 2016.

EMMI consulted on: (i) introducing a three-level "hybrid" methodology for calculating Euribor; (ii) producing an overnight tenor for Euribor following the implementation of the hybrid methodology; (iii) discontinuing the calculation of three of the eight tenors; (iv) clarifying Euribor's underlying interest; (v) ceasing the publication of individual Panel Banks' submissions; and (vi) simplifying the publication process.

EMMI has confirmed that Euribor's underlying interest will become "a measure of the rate at which wholesale funds in euro could be borrowed by credit institutions in the EU and EFTA countries in the unsecured money market." In addition, from December 3, 2018, EMMI will cease to publish individual Panel Bank's submissions and will only calculate and publish Euribor on an Act/360 day count basis. EMMI will consider which indicators and publication frequency will provide transparency on the benchmark's determination. EMMI announced on June 7, 2018 that three of the tenors—the two week, two month and nine month tenors—would be discontinued from December 3, 2018. The feedback from stakeholders to EMMI proposals indicated that there is insufficient interest to warrant producing an overnight tenor for Euribor and EMMI does not intend to proceed with it.

EMMI is currently testing the proposed methodology under live conditions, which will continue until August 2018. It intends to consult on the parameters of the methodology in Q3 2018. EMMI will provide further updates before the launch of the revised Euribor, which must take place in Q4 2019 at the latest to comply with the transitional period in the EU Benchmarks Regulation.

The feedback summary report is available at: https://www.emmi-benchmarks.eu/assets/files/D0244A-2018 Feedback Summary Consultation Hybrid Euribor-final version.pdf, details of EMMI's proposals are available at: https://finreg.shearman.com/european-money-markets-institute-consults-on-hybr and details of EMMI's announcement on discontinuing three of the tenors is available at: https://finreg.shearman.com/european-money-markets-institute-announces-cessat.

UK Regulations Implementing Parts of the Prospectus Regulation Published

On June 29, 2018, the Financial Services and Markets Act 2000 (Prospectus and Markets in Financial Instruments) Regulations 2018, dated June 27, 2018, was laid before Parliament. The U.K. Regulations will come into force on July 21, 2018, implementing parts of the Prospectus Regulation that will apply from that date. The remainder of its provisions take effect on July 21, 2019. The Prospectus Regulation, which will replace the existing Prospectus Directive, sets out the requirements for a prospectus to be published when securities are offered to the public or admitted to trading on a regulated market. The Prospectus Regulation aims to simplify the rules and administrative obligations for companies wishing to issue shares or debt on the market and reducing the costs of preparing a prospectus, thus fostering cross-border investments in the single market, while at the same time still enabling investors to make informed investment decisions.

U.K. law is not needed to transpose the Prospectus Regulation, which will be directly applicable across the EU. However, certain U.K. legislation will need to be amended to ensure that there is no conflict of laws. The U.K. Regulations amend the Financial Services and Markets Act by increasing the threshold, from €5 million to €8 million, for which a prospectus is required for an offer of securities to the public within the U.K. The U.K. Regulations also amend the U.K. legislation that implemented the Markets in Financial Instruments Directive, including by correcting the definition of a MiFID investment firm.

The U.K. Regulations (S.I. 2018/786) are available at:
http://www.legislation.gov.uk/uksi/2018/786/pdfs/uksi_20180786_en.pdf?_sm_au_=iVVM5DMRPQTJQZTQ
and the explanatory memorandum is available at:
http://www.legislation.gov.uk/uksi/2018/786/pdfs/uksiem_20180786_en.pdf?_sm_au_=iVVM5DMRPQTJQZTQ.

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 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

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 6, 2018: FSB consultation on proposed Recommendations for consistent national reporting of data on the use of compensation tools to address misconduct risk

July 9, 2018: FCA consultation on its approach to ex post impact evaluation

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 20, 2018: FSB call for feedback on the technical implementation of the TLAC Standard

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 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

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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