

Financial Regulatory Developments Focus

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

Our latest quarterly Governance & Securities Law Focus newsletter is available at:

http://www.shearman.com/~media/Files/NewsInsights/Publications/2014/01/Governance_and_Securities_Q4_BulletinCMCGFIAECEBLT012414.pdf.

Derivatives

ESMA Supplements its Technical Advice on Equivalence of Japanese Regime

On 30 January 2014, the European Securities and Markets Authority (“ESMA”) published supplemental technical advice to the European Commission on the equivalence of the Japanese regulatory regime to the EU regime under the European Market Infrastructure Regulations (“EMIR”). ESMA provided initial advice to the European Commission on 1 September 2013 relating to the recognition of third country central counterparties (“CCPs”) and the identification of duplicative or conflicting requirements for clearing, reporting, non-financial counterparties and risk mitigation. Since that advice was provided, ESMA has become aware that there is a separate regulatory regime in Japan for CCPs clearing commodities derivatives transactions and OTC commodities transactions (“Commodities CCPs”). ESMA’s advice in September 2013 only covered the recognition of third country CCPs clearing derivatives in securities, currencies, interest rates, credit, weather, GDP and other indices. ESMA’s advice to the Commission is that the Japanese regulatory regime for Commodities CCPs is broadly equivalent to the EU regime.

ESMA’s advice is available at: <http://www.esma.europa.eu/news/ESMA-delivers-second-set-advice-EMIR-equivalence-0?t=326&o=home>.

Regulatory Capital

EBA Recommends Use of LEI for Supervisory Purposes

On 29 January 2014, the European Banking Authority (the “EBA”) published a Recommendation on the use of unique identification codes for supervisory purposes for every bank and financial institution in the European Union. From July 2014, national regulators must submit data to the EBA on a sample number of financial institutions under the Implementing Technical Standards (“ITS”) on supervisory reporting, which covers areas such as own funds, financial information, large exposures, liquidity ratios, leverage ratios and asset encumbrance. National regulators have until 29 March 2014 to notify the EBA of whether they intend to comply with the Recommendation.

The Recommendation is available at:

<http://www.eba.europa.eu/documents/10180/561173/EBA-REC-2014-01+%28Recommendation+on+the+use+of+the+Legal+Entity+Identifier%29.pdf>.

EBA Publishes Final Draft RTS on Own Funds relating to Fixed Overheads

On 29 January 2014, the EBA published final draft Regulatory Technical Standards (“RTS”) on own funds requirements for investment firms with limited authorization to provide investment services. The RTS are required under the Capital Requirements Regulation which requires investment firms to hold eligible capital of at least one quarter of the fixed overheads of the previous year. The RTS outline the calculation of the fixed overheads and set out the conditions under which national regulators can adjust the capital requirement where there has been a material change in a firm’s business activities. The RTS are also relevant to management companies and alternative investment fund managers (“AIFMS”). The final draft RTS have been passed to the European Commission for its decision on endorsement.

The RTS are available at:

<http://www.eba.europa.eu/documents/10180/561374/EBA-RTS-2014-01+%28Own+Funds+-+Fixed+Overheads%29.pdf>.

EBA Announces Key Features of 2014 EU-wide Stress Test

On 31 January 2014, the EBA announced key features of the forthcoming 2014 EU-wide stress test that will be conducted on a sample of 124 EU banks at the highest level of consolidation. The resilience of EU banks will be assessed for the period 2014 to 2016 against a common set of risks including credit risk, market risk, sovereign risk, securitization and cost of funding. The test is part of the European Central Bank’s preparation for the implementation of the Single Supervisory Mechanism later this year. It is expected that the methodology and scenario relating to the stress test will be published in April 2014 and that banks’ individual results will be released at the end of October 2014.

The EBA announcement is available at:

<http://www.eba.europa.eu/documents/10180/563711/Communication+on+the+2014+EU-wide+stress+test.pdf>.

Financial Services

Joint Statement on US-EU Financial Markets Regulatory Dialogue

On 30 January 2014, the European Commission published a joint statement by the participants of the US-EU Financial Markets Regulatory Dialogue (the “FMRD”) who met to discuss and exchange information on regulatory developments and to identify regulatory conflicts. Participants include members of the European Commission, the European Supervisory Authorities (EBA, ESMA and European Insurance and Occupational Pensions Authority), the Board of Governors of the Federal Reserve System (“Federal Reserve Board”), the Commodity Futures Trading Commission (“CFTC”), the Federal Deposit Insurance Corporation, and the Securities and Exchange Commission (“SEC”). The following objectives were agreed:

- On derivatives, authorities will intensify discussions on the scope of equivalence and comparability findings, address any remaining impediments to reporting and reconvene in mid-2014. It was also agreed that any divergence on margin requirements for non-cleared OTC derivatives should be minimized.
- On banking, authorities need to cooperate to ensure the consistent implementation of prudential standards for global banks.
- On resolution, the participants committed to give priority to developing a shared understanding of the challenges involved in the effective resolution of large cross-border banks and to work together to find practical solutions.

The next meeting of the FMRD takes place in July, when the participants will discuss structural reform proposals.

The joint statement is available at:

http://ec.europa.eu/internal_market/ext-dimension/docs/dialogues/140129_us-eu-joint-statement_en.pdf.

EU Proposes Draft Legislation on Banking Structure Reform

On 29 January 2014, the European Commission published a proposed regulation to reform bank structure (the “Proposed Bank Structure Regulation”). The Regulation includes proposals to prohibit deposit-taking banks from proprietary trading and to give EU national regulators the power to require other ‘risky’ trading activities (such as market-making, securities underwriting, securitisation, complex derivatives) to be ring-fenced in a separate legal entity. The Proposed Bank Structure Regulation implements proposals originally included in the Liikanen Report. It is proposed that the ban on proprietary trading would apply

from 1 January 2017, and the ring-fencing powers would come into effect from 1 January 2018.

The Proposed Bank Structure Regulation is available at:

http://ec.europa.eu/internal_market/bank/docs/structural-reform/140129_proposal_en.pdf.

EU Proposed Draft Legislation on the Reporting and Transparency of Securities Financing Transactions

On 29 January 2014, the European Commission published a proposed regulation on the reporting and transparency of securities financing transactions (the “Proposed SFT Regulation”). The aim of the proposed Regulation is to improve the transparency of SFTs by requiring all transactions to be reported to trade repositories, requiring detailed reporting on the practices of investment funds engaged in SFTs and setting minimum standards for parties to rehypothecate a financial instrument. The Proposed SFT Regulation aims to prevent banks subject to the Proposed Bank Structure Regulation from moving activities subject to that proposed legislation to the shadow banking sector. The obligations under the Proposed SFT Regulation would apply to any EU financial or non-financial entity entering into a SFT.

The Proposed SFT Regulation is available at:

http://ec.europa.eu/internal_market/finances/docs/shadow-banking/140129_proposal_en.pdf.

SEC Publishes Draft Strategic Plan for Public Comment

On 3 February 2014, the SEC published for public comment its Draft Strategic Plan outlining the SEC’s strategic goals for fiscal years 2014 to 2018.

The SEC’s draft plan surveys the forces shaping its environment and outlines more than 70 initiatives designed to support its primary strategic goals. To comment on the 2014-2018 Draft Strategic Plan, send an e-mail to PerformancePlanning@sec.gov by 10 March 2014.

The full draft of the SEC strategic plan is available at:

<http://www.sec.gov/about/secstratplan1418.htm>

SEC Issues Risk Alert on Investment Advisers’ Due Diligence Processes for Selecting Alternative Investments

On 28 January 2014, the SEC’s Office of Compliance Inspections and Examinations (the “OCIE”) issued a Risk Alert on the due diligence processes that investment advisers use when they recommend or place clients’ assets in alternative investments such as hedge funds, private equity funds or funds of private funds. The alert describes current industry trends and practices in advisers’ due diligence. Additionally, the staff observed certain deficiencies in several advisory firms examined, as detailed in the report.

The full text of the report is available at:

<http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540687024>.

IOSCO Recommendations on the Protection of Client Assets

On 29 January 2014, the International Organization of Securities Commissions (“IOSCO”) published a report on the protection of client assets. The report includes eight principles which are intended to provide guidance to regulators on how to enhance their supervision of firms holding client assets by clarifying that the role of the intermediary is to ensure compliance with the relevant rules, including through risk management systems and internal controls to monitor compliance.

The report is available at:

<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD436.pdf>.

Consumer Protection

CFPB Supervision Report Highlights Mortgage Servicing Problems in 2013

On 30 January 2014, the Consumer Financial Protection Bureau (“CFPB”) issued a report highlighting a range of problems in the mortgage servicing market relating to unfair and deceptive practices, which were uncovered through the CFPB’s supervision program in 2013. In the report, the CFPB also announced changes to the format of supervisory reports in order to simplify them and to reduce the amount of time between an examination and the time of receipt of the report by the supervised institution.

The full text of the supervisory report is available at:

http://files.consumerfinance.gov/f/201401_cfpb_supervision-highlights.pdf.

Enforcement

State Street Fined by FCA

On 31 January 2014, the Financial Conduct Authority (“FCA”) published the final notice setting out the action taken against State Street for breaching the FCA Principles for Business relating to management and control, customers’ interests and communications with customers. The FCA found that State Street had charged customers substantial mark-ups on certain transitions which were not agreed to by the customers and which had been concealed from the customers. The regulator fined State Street £22,885,000 for the breaches.

The final notice is available at:

<http://www.fca.org.uk/your-fca/documents/final-notices/2014/state-street>.

FCA Publishes Warning Notice Statements

The FCA published two Warning Notice Statements on 3 February 2014 relating to warning notices it issued in November 2013 to individuals, both concerning

failings in relation to an interest rate benchmark. The power to publish Warning Notice Statements was conferred upon the FCA by the Financial Services Act 2012. The Statements may include such information that relates to a warning notice as the regulator considers appropriate.

The Warning Notice Statements are available at:

<http://www.fca.org.uk/your-fca/list?ttypes=Warning+notice+statements&yyear=&ssearch=>.

SEC Continues Microcap Fraud Crackdown, Proactively Suspends Trading in 255 Dormant Shell Companies

On 3 February 2014, the SEC announced the latest actions in its microcap fraud-fighting initiative known as *Operation Shell-Expel*, suspending trading in 255 dormant shell companies ripe for abuse in the OTC market. Since *Operation Shell-Expel* began in 2012, the SEC Enforcement Division's Office of Market Intelligence has been cleaning up the microcap marketplace by scrutinizing penny stocks nationwide and identifying clearly inactive companies. This has enabled the SEC to proactively suspend trading in several hundred dormant shell companies before market manipulation can occur.

Funds

FCA Guidance on AIFM Remuneration Code

On 31 January 2014, the FCA published finalized guidance on the AIFM Remuneration Code. The guidance took effect on 31 January 2014 and is directed to all firms authorized as full scope UK AIFMs.

The FCA Guidance is available at:

<http://www.fca.org.uk/static/documents/finalised-guidance/fg14-02.pdf>.

People

Barbara Lorenzen Named to Senior Position in National Exam Program

On 28 January 2014, the SEC announced that Barbara S. Lorenzen has been promoted to a senior position in the SEC's OCIE, which conducts the national examination program.

Molly Scherf Named Deputy Comptroller for Large Bank Supervision

On 29 January 2014, the Office of the Comptroller of the Currency announced the appointment of Mary H. (Molly) Scherf as Deputy Comptroller for Large Bank Supervision.

Janet Yellen Selected as the Chair of the Federal Open Market Committee and Sworn in as Chair of the Federal Reserve System

On 30 January 2014, the Federal Reserve Board announced that the Federal Open Market Committee, at its annual organizational meeting, unanimously selected Janet L. Yellen to serve as its Chair, effective 1 February 2014. She was sworn in as Chair of the Federal Reserve Board on 3 February 2014.

Events

CFTC's Global Markets Advisory Committee to Meet 12 February 2014

On 28 January 2014, the CFTC announced that it will convene a meeting of its Global Markets Advisory Committee on Wednesday, 12 February 2014, to discuss the CFTC staff's advisory issued on 14 November 2013, related to the CFTC's cross-border guidance addressing the applicability of certain CFTC regulations.

More information on the meeting is available at:

<http://www.cftc.gov/PressRoom/PressReleases/pr6842-14>

CFTC's Division of Market Oversight to Host Public Roundtable Regarding the Trade Execution Requirement and Package Transactions

On 31 January, the CFTC's Division of Market Oversight announced that it will hold a public roundtable on 12 February 2014, from 9:00 a.m. to 12:30 p.m. E.S.T., to discuss the application of the Commodity Exchange Act's trade execution requirement to so-called "package transactions."

The roundtable will discuss the following items with respect to transactions involving at least one swap subject to the trade execution requirement: 1) the definition of package transactions; 2) whether such transactions pose challenges in clearing or execution that are distinct from those applicable to the clearing or execution of stand-alone swaps subject to the trade execution requirement; and 3) potential solutions for trading package transactions on or pursuant to the rules of a Designated Contract Market or Swap Execution Facility.

Hearings

6 February: Oversight of Financial Stability and Data Security (Senate Committee on Banking, Housing, and Urban Affairs)

5 February: The Annual Report of the Office of Financial Research (House Committee on Financial Services)

5 February: The Impact of the Volcker Rule on Job Creators, Part II (House Committee on Financial Services)

4 February: The Federal Insurance Office's Report on Modernizing Insurance Regulation (House Committee on Financial Services)

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

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