

## Financial Regulatory Developments Focus



### In this issue:

- Derivatives
- Compensation
- Recovery & Resolution
- Bank Prudential Regulation and Regulatory Capital
- Financial Market Infrastructure
- Financial Services
- Consumer Protection
- People

**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.**

### Derivatives

#### Interim Solution for FX Derivatives Definition Proposed by European Commission

On 31 July 2014, the European Securities and Markets Authority (“ESMA”) published a letter (dated 23 July 2014) from the European Commission regarding the definition of derivatives for the purposes of reporting under the European Market Infrastructure Regulation (“EMIR”). Derivatives are defined by reference to the list set out in the Markets and Financial Instruments Directive (“MiFID I”) which, because it has been transposed into national laws by member states, has resulted in no common definition of a derivative or derivative contract in the EU, particularly for FX forwards and physically settled commodity forwards. ESMA had requested the Commission, in February of this year, to clarify the position using powers granted under MiFID I so as to provide certainty to market participants. The Commission’s letter to ESMA last week clarifies that the power referred to by ESMA ceased to apply in 2012. The definition will be able to be clarified in the Level 2 legislation required under the Markets in Financial Instruments Directive (“MiFID II”). However, that legislation is still pending and MiFID II only comes into effect on 1 January 2017. The Commission considers that the best way forward would be for ESMA to provide guidance in the interim period on the meaning of a FX contract. Such guidance may lead to a change in the practice and laws in some member states which may, by 2017, need to be amended again. The letter also sets out the current ‘broad consensus’ on the definition of FX spot contracts. The Commission consulted earlier this year on the definition of FX financial instruments and FX spot contract, the results of which are available at: [http://ec.europa.eu/internal\\_market/consultations/2014/foreign-exchange/index\\_en.htm](http://ec.europa.eu/internal_market/consultations/2014/foreign-exchange/index_en.htm).

The Commission’s letter is available at: <http://www.esma.europa.eu/content/EC-letter-ESMA-classification-financial-instruments>.

## Compensation

### Proposed Amendments to the UK Remuneration Code

On 30 July 2014, the Financial Conduct Authority (“FCA”) and the Prudential Regulation Authority (“PRA”) published a joint consultation “Strengthening the Alignment of Risk and Reward: New Remuneration Rules.” The consultation sets out proposed changes to the Remuneration Code and seeks to address the issues raised in the final report (published in June 2013) of the Parliamentary Commission on Banking Standards. The consultation was published alongside the combined consultation to implement proposals on the senior management regime (about which, see below under Financial Services). The consultation on changes to the Remuneration Code, which will affect all banks, building societies and PRA-designated investment firms, includes proposals: (i) to extend the deferral period for variable remuneration; (ii) to provide for an option for the clawback period to be extended for senior managers; (iii) to clarify the presumption against payment or vesting of discretionary payments for senior managers of a bank that has failed; (iv) on the possibility of introducing rules on buy-outs; (v) to introduce a requirement for all UK-regulated firms to calculate profit by deducting a prudential valuation adjustment figure from fair value accounting profit when calculating profit for the purpose of determining the size of the annual bonus pool; and (vi) introducing a rule that non-executive directors should not receive variable remuneration (in line with current practice). The PRA and FCA confirm that they do not intend to introduce further disclosure requirements at this time. The FCA also confirms that it will review financial incentive schemes for sales staff during its work to implement MiFID II.

The consultation paper is available at: <http://www.fca.org.uk/news/pr-a-and-fca-consult-on-proposals-to-improve-responsibility-and-accountability-in-the-banking-sector>.

## Recovery & Resolution

### Single Resolution Mechanism Regulation Enacted

On 30 July 2014, the EU Regulation establishing rules and procedures for the resolution of Eurozone banks and investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund (the “SRM Regulation”) was enacted. The SRM Regulation, for the most part, will be applicable from 1 January 2016.

The SRM Regulation is available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2014.225.01.0001.01.ENG](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.225.01.0001.01.ENG).

### FCA Consults on Draft Recovery & Resolution Rules for Investment Firms

On 1 August 2014, the FCA published proposals for changes to its Handbook required for transposition of the Bank Recovery and Resolution Directive (“BRRD”), which member states are obliged to transpose into national laws by 31 December 2014 and apply from 1 January 2015. Both HM Treasury and the PRA launched consultations on the transposition of the BRRD last week. The FCA will be the competent authority for investment firms and certain group entities which it prudentially regulates. The PRA will be the competent authority for banks and larger investment firms. The FCA paper, which includes draft rules, covers: (i) requirements for recovery plans; (ii) requirements and conditions for notification of failure or likelihood of failure; (iii) information for resolution planning; (iv) intra-group financial support agreements; (v) contractual recognition of bail-in; and (vi) early intervention. Responses to the consultation are due by 1 October 2014.

The FCA paper is available at: <http://www.fca.org.uk/static/documents/consultation-papers/cp14-15.pdf>.

### Bank Prudential Regulation and Regulatory Capital

#### EBA Proposes Revised Draft ITS on Supervisory Reporting

On 30 July 2014, the European Banking Authority (“EBA”) published final draft implementing technical standards (“ITS”) to amend the current standards on supervisory reporting under the Capital Requirements Regulation. The amended ITS, which will need to be adopted by the European Commission, are expected to be applicable for reporting as of December 2014. The EBA is proposing to delete the validation rules and the Data Point Model. In April 2014, the EBA detected that certain validation rules included in the current ITS were inaccurate following tests based on real data from reporting firms as well as answers submitted via the EBA’s Q&A tool. The deletion of the rules and model from the ITS will obviate the need for further revised ITS as a result of these issues. The EBA is proposing to publish the validation rules and Data Point Model on its website (expected in August).

The EBA announcement is available at: <http://www.eba.europa.eu/-/eba-issues-amended-technical-standards-on-supervisory-reporting-for-institutions>.

#### Federal Reserve Board Releases FOMC Statement

On 30 July 2014, the Board of Governors of the Federal Reserve System (“Federal Reserve Board”) issued a statement from the June meeting of the Federal Open Market Committee (“FOMC”). The FOMC statement indicated growth in economic activity in the second quarter along with improvement in labor market conditions. In addition, the FOMC reaffirmed its view that an accommodative stance of monetary policy remained appropriate and will continue to assess how long to maintain the current 0 to ¼ percent target range for the federal funds rate.

The full FOMC statement is available at:

[http://www.ny.frb.org/markets/opolicy/operating\\_policy\\_140730.html](http://www.ny.frb.org/markets/opolicy/operating_policy_140730.html).

## Financial Market Infrastructure

### ICE Benchmark Administration New ISDAFIX Administrator

On 4 August 2014, Intercontinental Exchange announced that ICE Benchmark Administration Limited (“IBA”) had, from 1 August 2014, taken over the role of administrator for the ISDAFIX, the benchmark for swap rates for four currencies (Euro, British pound, Swiss franc and US dollar).

The announcement is available at: <http://ir.theice.com/investors-and-media/press/press-releases/press-release-details/2014/ICE-Benchmark-Administration-Completes-ISDAFIX-Transition/default.aspx>.

## Financial Services

### UK Regulators Consult on Rules for Senior Manager Accountability and New Conduct Rules

On 30 July 2014, the FCA and the PRA launched a combined consultation, “Strengthening Accountability in Banking: a new regulatory framework for individuals,” to implement changes made to the Financial Services and Markets Act 2000 by the Financial Services (Banking Reform) Act 2013. The consultation was published alongside the combined consultation on proposals to amend the UK Remuneration Code (discussed above under Compensation). The consultation on strengthening accountability, which includes proposals to implement the senior managers regime, the certification regime and the new set of conduct of rules, set out how the regulators will implement the requirements to make it easier for firms and regulators to hold individuals in relevant firms to account. Senior managers located in the UK or overseas will be affected and the conduct rules will apply to most employees of relevant firms if they are located in the UK or deal with customers in the UK. Relevant firms are UK banks, building societies, credit unions and investment firms regulated by the PRA. The proposals do not currently include UK branches of firms headquartered outside of the UK, however, the UK Government has indicated that it intends to extend the scope (which it can only do through further legislation) to all firms that operate in the UK, including branches of foreign firms. In addition, under European law, the PRA and FCA do not assess the competence of individuals working in a UK branch of an EEA bank or investment firm. The FCA intends to consult further on this issue in the future. The PRA and FCA intend to publish a technical consultation in due course covering forms, consequential changes and transitional arrangements. The regulators are expected to publish final rules towards the end of the year. Responses to the consultation are due by 31 October 2014.

The consultation paper is available at: <http://www.fca.org.uk/news/pr-a-and-fca-consult-on-proposals-to-improve-responsibility-and-accountability-in-the-banking-sector>.

#### **Next Steps Set Out for the Fair and Effective Markets Review**

On 30 July 2014, the terms of reference of the Fair and Effective Markets Review were published by HM Treasury, the Bank of England and the FCA. The Review will focus on the regulated and unregulated wholesale markets where misconduct issues have recently arisen (fixed income, currency and commodity markets, including related derivatives and benchmarks). The scope of the Review will cover trading practices, the regulatory perimeter, impact of recent and forthcoming regulation and supervision. The Review will be led by HM Treasury, the Bank of England and the FCA but will also include a separate market practitioner panel which will feed into the Review. The terms of reference of the market practitioner panel were also published. The terms state that the Review will, by June 2015, recommend: (i) principles to govern the operation of fair and effective financial markets; (ii) reforms to address standards of behavior; (iii) tools to strengthen the supervision of market conduct; (iv) whether the regulatory perimeter should be extended; and (v) any additional reforms to those already in play that may be necessary. In the interim, the Review must recommend a list of additional benchmarks that should be supervised under UK legislation. A consultation on the issues and proposals is expected in autumn.

Information about the Review is available at:

<http://www.bankofengland.co.uk/publications/Pages/news/2014/107.aspx>.

#### **FCA: Firms Are Failing to Deliver Best Execution**

On 31 July 2014, the FCA announced that following a review, it found that firms were failing to deliver best execution for both retail and professional clients when trading on their behalf. The FCA found that many firms do not: (i) understand the rules properly; (ii) control client costs when executing orders; or (iii) have sufficient managerial oversight of staff delivering best execution. The FCA expects all firms to review their best execution arrangements and take action to ensure that they comply with the rules. The FCA best execution rules will be amended once MiFID II is applicable in 2017. Under MiFID II, firms will be subject to a range of new requirements including disclosure of the top five most frequently used venues by the firm, disclosure of the costs of execution venues used by the firm, a ban on remuneration for routing client orders and stricter criteria for order execution policies.

The FCA announcement is available at: <http://www.fca.org.uk/news/fca-finds-firms-fail-to-deliver-best-execution>.

### Proposed Changes to Guidance on Money Laundering for the Financial Sector

On 25 July 2014, the Joint Money Laundering Steering Group (“JMLSG”) published proposed amendments to its Money Laundering Guidance for the Financial Sector. The JMLSG is made up of financial industry trade associations and aims to assist in the interpretation of anti-money laundering requirements. The proposals do not include any specific changes as a result of the proposed Fourth Money Laundering Directive (which is still going through the EU legislative process). Responses to the consultation are due by 15 September 2014.

The consultation information is available at: <http://www.jmlsg.org.uk/news/proposed-amendments-to-jmlsg-guidance>.

### SEC Modifies Municipalities Disclosure Initiative

On 31 July 2014, the Securities and Exchange Commission’s (“SEC”) Enforcement Division announced modifications to its Municipalities Continuing Disclosure Cooperation Initiative (the “Initiative”). Under the Initiative, announced on 10 March 2014, the SEC’s Enforcement Division agreed to recommend standardized settlement terms for municipal issuers and underwriters who self-report inaccurate statements made in bond offerings about their prior compliance with continuing disclosure obligations under the Securities Exchange Act of 1934.

The SEC announced that it would extend the deadline for smaller municipal securities underwriter firms and municipal issuers to self-report potential violations from 10 September 2014 to 1 December 2014. For underwriters, the deadline for compliance remains unchanged at 10 September 2014. However, the SEC announced that it would take a tiered approach to civil penalties based on the size of the underwriters.

Finally, the SEC announced that if violations are identified after the expiration of the Initiative, the SEC’s Enforcement Division would consider factors such as reasonable good faith, as well as documented efforts in deciding whether to recommend enforcement action and, as applicable, in determining relief.

The full text describing the Initiative is available at: <http://www.sec.gov/divisions/enforce/municipalities-continuing-disclosure-cooperation-initiative.shtml>.

## Consumer Protection

### ESMA Warns about Risks in CoCos

On 31 July 2014, ESMA published a statement warning institutional investors about the potential risks of investing in contingent convertible instruments, known in the financial markets as CoCos. ESMA is concerned because CoCos are very complex and differ from traditional instruments in a number of ways. ESMA’s concerns relate

specifically to trigger levels, coupon cancellation, capital structure inversion risk, call extension risk and yield or valuation risk.

ESMA's statement is available at: <http://www.esma.europa.eu/news/ESMA-Statement-Potential-Risks-Associated-Investing-Contingent-Convertible-Instruments?t=326&o=home>.

### ESAs Remind Banks and Insurance Firms on Self Placement Obligations

On 31 July 2014, the European Supervisory Authorities (the EBA, ESMA and the European Insurance and Occupational Pensions Authority) published a statement reminding banks and insurance firms that they are expected to comply with all EU requirements when placing financial instruments with depositors, retail investors and policy holders. The ESAs are concerned that firms are using self placement as a means of complying with the recently introduced enhanced prudential requirements, such as the capital requirements legislation, the BRRD and Solvency 2, and in so doing, do not comply with their other legal obligations and may put investors at risk.

The statement is available at: <https://eiopa.europa.eu/joint-committee/index.html>.

### OCC Releases Risk Management Guidance

On 4 August 2014, the Office of the Comptroller of the Currency ("OCC") issued guidance to national banks and federal savings associations (collectively "banks") on the application of consumer protection requirements and banking practices to consumer debt-sale arrangements with third parties that intend to pursue collection of the underlying obligations.

Among other things, the OCC guidance emphasizes that: (i) a bank must have in place appropriate internal policies and procedures that govern debt-sale arrangements consistently across the bank; (ii) banks must be performing appropriate due diligence when selecting debt buys; (iii) banks must provide accurate and comprehensive information regarding each debt sold, at the time of sale; (iv) banks must ensure compliance with applicable consumer protection laws and regulations; and (v) banks must implement appropriate oversight of debt-sale arrangements.

The full text of the OCC bulletin is available at: <http://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-37.html>.

### People

On 4 August 2014, the Bank of England announced **Spencer Dale**, the Bank's Executive Director for Financial Stability Strategy and Risk, will leave the Bank and start a new job as Chief Economist at BP plc in October 2014.

**Minouche Shafik**, as Deputy Governor for Markets & Banking, and **Paul Fisher**, Executive Director, Supervisory Risk Specialists & Regulatory Operations and Deputy CEO, have been appointed to the Board of the PRA. In addition, **Sandra Boss** and **Mark Yallop** have been appointed as independent members of the Board of the PRA. Sandra's appointment is effective on 1 September 2014 and Mark will join from 1 December 2014.

On 30 July, the SEC announced the appointment of **Alberto Arevalo** as the Associate Director in the Office of International Affairs. The Federal Depository Insurance Corporation appointed **Segundo Pereira** as Director of the Office of Minority and Women Inclusion.

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:

## EUROPE

### **BARNEY REYNOLDS**

T: +44 20 7655 5528

[barney.reynolds@shearman.com](mailto:barney.reynolds@shearman.com)

London

### **AZAD ALI**

T: +44 20 7655 5659

[azad.ali@shearman.com](mailto:azad.ali@shearman.com)

London

### **ANNA DOYLE**

T: +44 20 7655 5978

[anna.doyle@shearman.com](mailto:anna.doyle@shearman.com)

London

### **ELLIE TEO**

T: +44 20 7655 5070

[ellerina.teo@shearman.com](mailto:ellerina.teo@shearman.com)

London

### **JAMES CAMPBELL**

T: +44 20 7655 5570

[james.campbell@shearman.com](mailto:james.campbell@shearman.com)

London

### **THOMAS DONEGAN**

T: +44 20 7655 5566

[thomas.donegan@shearman.com](mailto:thomas.donegan@shearman.com)

London

### **JOHN ADAMS**

T: +44 20 7655 5740

[john.adams@shearman.com](mailto:john.adams@shearman.com)

London

### **MARIA CHAN**

T: +44 20 7655 5835

[maria.chan@shearman.com](mailto:maria.chan@shearman.com)

London

### **NATALIE CALDWELL**

T: +44 20 7655 5722

[natalie.caldwell@shearman.com](mailto:natalie.caldwell@shearman.com)

London

### **BILL MURDIE**

T: +44 20 7655 5149

[bill.murdie@shearman.com](mailto:bill.murdie@shearman.com)

London

### **KOLJA STEHL**

T: +49 69 9711 1623

[kolja.stehl@shearman.com](mailto:kolja.stehl@shearman.com)

Frankfurt / London

### **MAK JUDGE**

T: +44 20 7655 5182

[mak.judge@shearman.com](mailto:mak.judge@shearman.com)

London / Singapore

### **OLIVER LINCH**

T: +44 20 7655 5715

[oliver.linch@shearman.com](mailto:oliver.linch@shearman.com)

London

## AMERICAS

### **DONALD N. LAMSON**

T: +1 202 508 8130

[donald.lamson@shearman.com](mailto:donald.lamson@shearman.com)

Washington, DC

### **BRADLEY K. SABEL**

T: +1 212 848 8410

[bsabel@shearman.com](mailto:bsabel@shearman.com)

New York

### **CHRISTINA BROCH**

T: +1 202 508 8028

[christina.broch@shearman.com](mailto:christina.broch@shearman.com)

Washington, DC

### **RUSSELL D. SACKS**

T: +1 212 848 7585

[rsacks@shearman.com](mailto:rsacks@shearman.com)

New York

### **JENNIFER D. MORTON**

T: +1 212 848 5187

[jennifer.morton@shearman.com](mailto:jennifer.morton@shearman.com)

New York

### **JARED R. GIANATASIO**

T: +1 212 848 4384

[jared.gianatasio@shearman.com](mailto:jared.gianatasio@shearman.com)

New York

### **DONNA M. PARISI**

T: +1 212 848 7367

[dparisi@shearman.com](mailto:dparisi@shearman.com)

New York

### **SYLVIA FAVRETTO**

T: +1 202 508 8176

[sylvia.favretto@shearman.com](mailto:sylvia.favretto@shearman.com)

Washington, DC

---

ABU DHABI | BEIJING | BRUSSELS | FRANKFURT | HONG KONG | LONDON | MILAN | NEW YORK | PALO ALTO  
PARIS | ROME | SAN FRANCISCO | SÃO PAULO | SHANGHAI | SINGAPORE | TOKYO | TORONTO | WASHINGTON, DC

shearman.com

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069

Copyright © 2014 Shearman & Sterling LLP. Shearman & Sterling LLP is a limited liability partnership organized under the laws of the State of Delaware, with an affiliated limited liability partnership organized for the practice of law in the United Kingdom and Italy and an affiliated partnership organized for the practice of law in Hong Kong.