

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.

Derivatives

CFTC Announces Extension of No-Action Relief for SEFs and DCMs from Compliance with Certain CFTC Regulations for Package Transactions

On September 30, 2014, the US Commodity Futures Trading Commission's ("CFTC") Divisions of Clearing and Risk and Market Oversight announced the extension of time-limited no-action relief for Swap Execution Facilities ("SEFs") and Designated Contract Markets ("DCMs"). The extension exempts SEFs and DCMs from compliance with CFTC Regulation 37.9(a)(2) for methods of execution for required transactions, or CFTC Regulations 37.203(a) and 38.152 that prohibit pre-arranged trading, if a SEF or DCM permits a new trade, with terms and conditions identical to the terms and conditions of the original trade (other than the time of execution), to be submitted for clearing. The previous no-action relief will be extended to allow for additional time for market participants to develop the necessary technological solutions to comply with the CFTC regulations. The extended no-action relief will expire on February 16, 2015.

The full text of the CFTC no-action letter is available at:

<http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-121.pdf>.

CFTC and Australian Securities and Investments Commission Sign Memorandum of Understanding to Enhance Supervision of Cross-Border Regulated Entities

On September 30, 2014, the CFTC announced the signing of a Memorandum of Understanding ("MOU") with the Australian Securities and Investments Commission regarding cooperation and the exchange of information in the supervision and oversight of regulated entities that operate on a cross-border basis in the United States and in Australia. The scope of the MOU covers markets and organized trading platforms, trade repositories, intermediaries, dealers and other market participants.

The full text of the MOU is available at:

<http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/file/cftc-asic-supervisorymou092414.pdf>.

EU Final Draft Technical Standards on Mandatory Clearing of IRS Published

On October 1, 2014, the European Securities and Markets Authority (“ESMA”) published its final draft regulatory technical standards (“RTS”) for the central clearing of Interest Rate Swaps (“IRS”). The final draft RTS define four classes of IRS contracts which will be subject to central clearing. They also set out a phased-in implementation schedule for counterparties which will be required to clear the relevant IRS. Clearing members will be the first counterparties subject to the obligation and must clear the relevant IRS from six months after the RTS enter into force (category 1). Financial counterparties and alternative investment funds that belong to a group whose aggregate month-end average notional amount of uncleared derivatives for three months preceding the entry into force of the RTS is above EUR 8 billion must clear the relevant IRS from 12 months after the RTS come into force (category 2). Financial counterparties and alternative investment funds whose trading activities do not amount to the above will only need to clear from 18 months from entry into force of the RTS (category 3). Non-financial counterparties will have to clear the relevant IRS from three years after the RTS enter into force (category 4). Market participants should note that the categories have been tweaked from the original proposed categories set out in the draft RTS that ESMA consulted on. The final draft RTS must be adopted by the European Commission and published in the Official Journal of the European Union before they can enter into force. It is currently expected that clearing of the relevant IRS will become mandatory for clearing members around mid-2015.

The final draft RTS are available at: <http://www.esma.europa.eu/news/ESMA-defines-products-counterparties-and-starting-dates-clearing-interest-rate-swaps?t=326&o=home>.

ESMA Launches Consultation on Clearing Obligation of FX NDF Derivatives

On October 1, 2014, ESMA launched a consultation on proposed draft RTS on the clearing obligation for a class of foreign exchange non-deliverable forward (FX NDF) OTC derivatives. The consultation paper includes the proposed draft RTS and covers: (i) an analysis for the determination of the class of OTC FX NDF that ESMA is proposing as being subject to the clearing obligation under the European Market Infrastructure Regulation (“EMIR”); (ii) the counterparties that ESMA proposes should be subject to the obligation and the implementation dates for each category of counterparty; and (iii) the proposed approach for frontloading and the definition of the minimum remaining maturities of the contracts subject to frontloading. The clearing obligation for relevant FX NDFs will come into effect six months after the RTS come into effect for clearing members, after 12 months for financial counterparties and alternative investment funds, after 18 months for smaller financial counterparties and alternative investment funds and after 33 months for non-financial counterparties. The consultation is open until

November 6, 2014. ESMA is required to provide its final draft RTS to the European Commission by December 12, 2014.

The consultation paper is available at: <http://www.esma.europa.eu/news/ESMA-consults-draft-standards-clearing-foreign-exchange-non-deliverable-forwards?t=326&o=home>.

Consultation on Proposed Guidelines on the Definitions of Derivatives under MiFID I

On September 29, 2014, ESMA published a consultation on proposed guidelines on the application of the definition of FX and physically settled commodity forwards under the Market in Financial Instruments Directive (“MiFID I”). The lack of consistent interpretation and application of the definitions of these derivatives to date may have an impact on the application of EMIR. ESMA is considering publishing guidelines to provide clarity on the application of the definitions with the aim of harmonizing the approach across the EU. Under MiFID II, which comes in effect on January 3, 2017, the European Commission is able to adopt secondary legislation which specifies the derivatives contracts that must be physically settled (as listed in Points (6) and (7) of Section C of Annex I to MiFID II). ESMA has been asked to provide technical advice to the European Commission to assist in the preparation of such legislation. The guidelines that ESMA is proposing to adopt are intended as an interim measure until such time as the Level 2 legislation is finalized and in effect across the EU.

ESMA’s consultation paper is available at:

<http://www.esma.europa.eu/news/ESMA-consults-draft-guidelines-clarifying-definition-derivatives-under-MiFID?t=326&o=home>.

ESMA Postpones Due Date for Delivery of Reports under EMIR

On September 30, 2014, ESMA published its letter, dated September 29, 2014, to the European Commission on the postponement of various reports due by ESMA under EMIR. The letter states that the reports due by ESMA will be prepared at a later date because developments, such as CCP authorization and implementation of the clearing obligation, have taken longer than anticipated. Without the practical implementation of the requirements under EMIR, ESMA does not consider that it is practical to prepare the reports until it is able to reflect on the experience gained.

The letter is available at:

<http://www.esma.europa.eu/documents/overview/10?page=1>.

Assessment of Incentives for Central Clearing of OTC Derivatives

On October 3, 2014, the Bank for International Settlements published a report on the assessment of the reforms to incentivise central clearing of OTC derivatives contracts. The assessment found that clearing members have incentives to clear centrally. Market participants clearing indirectly may not have any incentives, however, the report states that there is currently insufficient data to analyze their activities to draw any firm conclusions. The report concludes that to the extent

that clearing members account for most of derivatives trading, the G20 objective for OTC derivatives reforms has been achieved.

The report is available at: <http://www.bis.org/publ/othp21.pdf>.

Bank Prudential Regulation & Regulatory Capital

Federal Reserve Board Announces Study on the Effects of Revised Regulatory Capital Framework

On September 30, 2014, the Board of Governors of the Federal Reserve System (“Federal Reserve Board”) announced that it will begin a quantitative impact study (“QIS”) in order to evaluate the effects of the revised regulatory capital framework on savings and loan holding companies and nonbank financial companies supervised by the Federal Reserve Board that are substantially engaged in insurance underwriting activity (“insurance holding companies”). Until this point, the revised regulatory capital framework implementing the Basel III capital rules excluded insurance underwriting activity in order to allow the Federal Reserve Board additional time to formulate an appropriate regulatory capital framework. The results of the QIS will be used in the design of a capital framework for insurance holding companies under the supervision of the Federal Reserve Board.

All insurance holding companies contacted by the Federal Reserve Board requesting participation in the QIS must submit information by December 31, 2014.

The full text of the QIS instructions is available at:

<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140930a2.pdf>.

The full text of the QIS reporting template is available at:

<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140930a3.pdf>.

OCC Extends Application of Certain Guidance to Federal Savings Associations

On October 1, 2014, the Office of the Comptroller of the Currency (“OCC”) announced that certain OCC and interagency guidance was applicable to federal savings associations (“FSAs”). In line with previous OCC bulletins revising guidance to apply consistently to national banks and FSAs, the announcement by the OCC extends the application of certain OCC and interagency guidance to FSAs.

The full list of the guidance applicable to FSAs is available at:

<http://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-49.html>.

ECB Guide to Banking Supervision under the SSM

On September 30, 2014, the European Central Bank (“ECB”) published a guide to banking supervision which sets out the implementation of the Single Supervisory Mechanism (“SSM”). The SSM is made up of the ECB and national regulators of euro area countries. The ECB, which will begin its supervisory tasks on November 4, 2014, will be responsible for the functioning of the SSM and will

directly prudentially supervise the larger banks within the ECB. National regulators will supervise smaller banks and will be responsible for all other conduct and regulatory supervision of banks and other regulated firms in their jurisdictions. The ECB guide sets out how the SSM will work in practice.

The guide is available at:

<http://www.ecb.europa.eu/pub/pdf/other/ssmguidebankingsupervision201409en.pdf>.

ESMA Consults on Level 2 Measures on Main Indices and Recognized Exchanges under CRR

On September 29, 2014, ESMA published a consultation paper on the specification of main indices and recognized exchanges, for the purposes of the Capital Requirements Regulation (“CRR”). The CRR determines the way in which firms must treat the credit risk of assets for which collateral has been taken. It sets out when securities are eligible as collateral, referring to equities and convertible bonds that are part of a “main index” and to debt securities that are listed on a recognized exchange. ESMA is required to prepare draft implementing technical standards (“ITS”) specifying the main indices and recognized exchanges for those purposes. The consultation paper includes the proposed draft ITS, lists the main indices (Annex 1) and recognized exchanges (Annex 2) and describes the approach taken in identifying the relevant indices and exchanges. The consultation closes on November 1, 2014. ESMA is required to submit its proposed final draft ITS to the European Commission before December 31, 2014.

The consultation paper is available at:

<http://www.esma.europa.eu/consultation/Consultation-draft-Implementing-Technical-Standards-main-indices-and-recognised-exchang>.

EBA Publishes Indicators from 28 EU G-SIIs

On September 29, 2014, the European Banking Authority (“EBA”) published indicators from 28 EU large firms in the form of a document containing tables and charts and a disclosure tool in Excel format. Under the CRR and the Capital Requirements Directive (“CRD IV”), national regulators are required to identify as global systemically important institutions (“G-SIIs”) firms that present a higher risk to the global financial system. The identification of EU firms as G-SIIs will take place in January 2015 for the first time. The higher capital requirement will apply one year after the publication by national regulators of the results. The timeframe is intended to give relevant firms enough time to adjust to the new buffer requirements. The ITS setting out the uniform formats and date for the disclosure of the values used to identify G-SIIs under CRD IV was published in the Official Journal of the European Union on September 30, 2014 and will come into force on October 20, 2014. The ITS include a template for a firm to disclose the values of the indicators used for determining its score.

The EBA announcement is available at <http://www.eba.europa.eu/-/eba-publishes-indicators-from-global-systemically-important-institutions-g-siis> and the ITS is

available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOL_2014_284_R_0006&from=EN.

Recovery & Resolution

EBA Consults on Level 2 and Level 3 Measures for Intra-group Financial Support under BRRD

On October 3, 2014, the EBA launched a consultation on proposed draft RTS and proposed guidelines on the conditions for the provision of financial support by a group entity to another group entity that meets the requirements for early intervention under the Banking Recovery and Resolution Directive (“BRRD”). Under the BRRD, member states are required to remove any legal obstacles to intra-group financial support agreements subject to certain limitations which may be imposed under CRR and CRD IV. The BRRD sets out certain conditions for the provision of support which relate to the expected success of the support, the impact on financial stability, prudential requirements applicable to the providing entity providing support and the terms of the support. The EBA must provide draft RTS to the European Commission further specifying some of those conditions, and it must also issue guidelines which will help to promote harmonized approaches to other conditions. The consultation also proposes draft ITS on the form and content of the disclosure of support agreements as required under the BRRD. The EBA proposes that the general terms of a support agreement should be made available on a firm’s website setting out all of the relevant information while taking into account the need for confidentiality of certain specific information. The consultation closes on January 4, 2015.

The consultation paper is available at:

<http://www.eba.europa.eu/documents/10180/835368/EBA-CP-2014-30+%28CP+on+RTS+and+GL+on+Conditions+for+Group+Fin++Support+and+on+ITS+on+Disclosure%29.pdf>.

EBA Proposes Guidelines on Treatment of Liabilities in Bail-in

On October 1, 2014, the EBA published for consultation draft guidelines on the treatment of liabilities in bail-in under the BRRD. The BRRD provides the sequence for application of the power to write down or convert liabilities in resolution, specifying that capital instruments (as defined under the CRR) should bear losses first, before other liabilities. The EBA is tasked with issuing guidelines that clarify the interrelationship between these provisions of the BRRD and the hierarchy of capital instruments in the CRR and CRD IV. The proposed guidelines aim to eliminate ambiguity about which category of write down sequence a particular instrument belongs to. Responses to the consultation are due by January 3, 2015. The EBA will be consulting on other aspects of the bail-in regime later this year.

The consultation paper is available at:

<http://www.eba.europa.eu/documents/10180/833064/EBA-CP-2014-29+%28CP+on+GL+on+Interrelationship+BRRD+and+CRR-CRD%29.pdf>.

PRA Consults on Operational Continuity in Resolution

On October 6, 2014, the Prudential Regulation Authority (“PRA”) published a discussion paper on ensuring operational continuity in resolution in banks, building societies and investment firms regulated by the PRA. The proposals relate to the PRA’s Fundamental Rule that a firm must prepare for resolution so that it can be resolved in an orderly manner with minimal disruption to critical services. The proposals include three potentially effective structures for ensuring continuity of critical shared services, design principles which set out the necessary outcomes to be achieved and assessment criteria for determining whether a firm complies with the requirements. Responses to the consultation paper are due by January 6, 2015. The PRA states that it may issue a subsequent consultation paper with draft rules in 2015. The discussion paper is one of four papers published by the PRA relating to resolution and resilience. The other papers consider proposals on depositor protection, insurance policyholder protection and structural reform for implementing the ring-fencing requirements.

The discussion paper is available at:

<http://www.bankofengland.co.uk/pr/Documents/publications/cp/2014/dp114.pdf>.

PRA Consults on Rules for Depositor Protection Schemes

On October 6, 2014, the PRA issued a consultation paper on proposed rule changes required to implement the recast Deposit Guarantee Schemes Directive (the “DGSD”), to ensure continuity of access during resolution to accounts for depositors protected by the Financial Services Compensation Scheme (“FSCS”) and changes to the single customer view requirements for firms. Member states are required to transpose the DGSD into national law by July 3, 2015. The PRA intends to publish final rules, supervisory statements and its statement of policy on the FSCS in the first half of 2015. The regulator will consult on various other related rules in 2015. Responses to this consultation are requested by January 6, 2015.

The consultation paper is available at:

<http://www.bankofengland.co.uk/pr/Documents/publications/cp/2014/cp2014.pdf>.

Bank Structure

PRA Requests Preliminary Ring-fencing Plans and Consults on Implementing Rules

On October 6, 2014, the PRA launched a consultation on implementation proposals of the ring-fencing requirements relating to legal structure of banking groups, governance arrangements for ring-fenced bodies and the continuity of services and facilities to ring-fenced bodies. The PRA intends to consult further during 2015, including on issues such as intra-group arrangements and concessions, prudential requirements and standards as well as disclosure and reporting. Responses to the PRA consultation are due by January 6, 2015. The PRA aims to publish its final rules and supervisory statements during the first half of 2016. The ring-fencing rules will be applicable from 2019. As an interim

measure, the PRA is requesting all firms that expect to be subject to the ring-fencing rules by 2019 to submit a preliminary plan to the PRA and the Financial Conduct Authority by January 6, 2015 to assist the regulators in deciding on the approach to implementation. The preliminary plans should include financial statements, a plan for transitioning to preferred legal and operating structures, any new regulatory authorizations, permissions, waivers or Part VII transfers that may be required as well as key milestones and decision points.

The consultation paper is one of four papers published by the PRA relating to resolution and resilience. The other papers consider proposals on operational continuity during resolution, depositor protection and insurance policyholder protection.

The PRA consultation paper is available at:

<http://www.bankofengland.co.uk/pr/Documents/publications/cp/2014/cp1914.pdf>.

Shadow Banking

IMF Report on Shadow Banking

On October 1, 2014, the International Monetary Fund published a Global Financial Stability Report which includes a chapter on shadow banking. The report looks at the risks and advantages involved in shadow banking as well as key policy concerns and issues arising relating to systemic risk.

The report is available at:

<http://www.imf.org/external/pubs/ft/gfsr/2014/02/pdf/c2.pdf>.

Financial Services

FSB Final Report on Improving FX Benchmarks and FX Market Structure

On September 30, 2014, the Financial Stability Board (“FSB”) published its final report on FX benchmarks. The report is the work of an FSB working group set up to focus on FX benchmarks due to the concerns raised about the integrity of FX benchmarks and the incentives for potential misconduct linked to the structure of trading around the benchmark fixings. The report covers: (i) an analysis of the FX market structure; (ii) incentives for market misconduct; (iii) remedies to address any adverse incentives; and (iv) recommendations for improving the construction of benchmarks. The report includes 15 specific recommendations for improving market structure and conduct which the working group considers can be implemented by industry participants. However, the report notes that national authorities may determine that regulatory change is necessary to ensure that the improvements take effect and as a result of investigations into alleged misconduct in the benchmark markets. The report also supports the recommendations of the International Organization of Securities Commissions for the WM/Reuters 4 p.m. Closing Spot Rate by The World Markets Company PLC.

The report is available at:

http://www.financialstabilityboard.org/publications/r_140930.pdf.

People

On October 6, 2014, the CFTC announced that Eric Juzenas, Petal Walker, and Justin Slaughter will join CFTC Commissioner Sharon Bowen's staff as her Principal Adviser, Chief Counsel and Chief Policy Adviser, and Special Counsel, respectively. The legal and policy staff will work with the Commissioner to carry out the CFTC's efforts to implement the Dodd-Frank Act and ensure compliance with CFTC regulations.

On October 3, 2014, the OCC named Kathy K. Murphy as the agency's Senior Deputy Comptroller for Management and Chief Financial Officer.

Events

The US Securities and Exchange Commission ("SEC"), Financial Industry Regulatory Authority ("FINRA"), and the Municipal Securities Rulemaking Board ("MSRB") will hold a Compliance Outreach Program for Municipal Advisors in Chicago, IL on November 3, 2014.

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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