

Financial Regulatory Developments Focus



In this issue:

Bank Prudential Regulation &
Regulatory Capital

Compensation

Consumer Protection

Derivatives

Enforcement

Financial Services

Funds

Recovery & Resolution

People

Events

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.

Bank Prudential Regulation & Regulatory Capital

Federal Reserve Board Establishes Concentration Limits for Financial Companies

On November 5, 2014, the US Board of Governors of the Federal Reserve System (“Federal Reserve Board”) issued a final rulemaking that establishes concentration limits for large financial companies. The final rule implements Section 622 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and will be effective January 1, 2015.

The final rulemaking largely follows the initial proposal in May 2014. Generally, the rule prohibits a financial company from merging, acquiring, or otherwise combining with another company unless the combined organizations’ ratio of financial liabilities of financial companies as a whole remains below 10%. The final rule creates an exemption to allow companies to still engage in securitization transactions even if the limit has been reached.

Under the rule, liabilities are defined as the difference between adjusted risk-weighted assets and total regulatory capital. Companies subject to the rule include bank holding companies, savings and loan holding companies, foreign banking organizations (“FBOs”), depository institutions and companies that control insured depository institutions, and nonbank financial companies designated as systemically important by the Financial Stability Oversight Council.

The final rule is available at:

<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20141105a1.pdf>.

Delegated Regulation Under CRD IV Published in Official Journal of the European Union

On November 7, 2014, the Delegated Regulation supplementing the Capital Requirements Directive IV (“CRD IV”) package with regard to regulatory technical standards (“RTS”) for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets was published in the Official Journal of the European Union. The Delegated

Regulation deals with the identification of exposures resulting from transactions, underlying exposures to transactions which themselves have underlying assets, calculation of exposure value, procedure for determining the contribution of underlying exposures to overall exposures, and additional exposure constituted by the structure of a transaction. The Delegated Regulation applies to credit institutions and certain investment firms, and enters into force on November 27, 2014.

The Delegated Regulation is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.324.01.0001.01.ENG.

HM Treasury Consults on Granting Powers to Financial Policy Committee to Set Leverage Ratio Requirements

On November 7, 2014, HM Treasury published a consultation paper seeking views on how to implement the Financial Policy Committee's ("FPC") recommendations, which follow from the FPC's review of the role of the leverage ratio in the capital framework for UK banks and large investment firms. The FPC recommended that HM Treasury enables the FPC to give directions to the Prudential Regulation Authority ("PRA") to set leverage ratio requirements and buffers for PRA-regulated institutions. The FPC has stated that the directions should include a minimum leverage ratio requirement, a supplementary leverage ratio buffer to apply to global systemically important banks ("G-SIBs") and major UK institutions, as well as a countercyclical ratio buffer. HM Treasury's consultation paper seeks views on how to implement the FPC's recommendations and grant the FPC such powers of direction. The consultation closes on November 28, 2014.

The consultation paper is available at: <https://www.gov.uk/government/consultations/financial-policy-committees-leverage-ratio-framework>.

Updated List of Global Systemically Important Banks Published

On November 6, 2014, the Financial Stability Board ("FSB") published an updated list of G-SIBs. The list, which was updated jointly by the FSB and the Basel Committee on Banking Supervision ("Basel Committee") now includes one additional bank: the Agricultural Bank of China. Simultaneously, the Basel Committee released supporting information explaining the methodology and denominators used to calculate banks' scores as well as the cut-off scores used to identify the G-SIBs.

The updated list is available at: http://www.financialstabilityboard.org/wp-content/uploads/r_141106b.pdf, and the supporting information is available at: <http://www.bis.org/press/p141106.htm>.

Compensation

Prudential Regulation Authority and Financial Conduct Authority Publish Joint Policy Statement on Data Collection on Remuneration Practices

On November 7, 2014, the PRA and Financial Conduct Authority (“FCA”) published a joint Policy Statement on data collection on remuneration practices under CRD IV which sets out the final remuneration data reporting requirements to be included in the PRA and FCA handbooks. The new requirements relate to updated templates to be used for the Benchmarking Information Report (“BIF”) and High Earners Report (“HER”) as part of the data collection exercises.

The updated BIF requires added detail to be included for the collecting of remuneration data, so as to ensure a more effective analysis of practices across different classes of staff. Significant banks, building societies and designated investment firms that are PRA-regulated, with a total of £50 billion in assets or more, have previously been subject to this type of exercise. Firms prudentially regulated by the FCA with total assets of £50 billion or more are now also subject to this exercise.

The updated HER requires firms to submit details on all employees with a total remuneration of €1 million or more per financial year. The scope for PRA-regulated firms remains the same, though more FCA firms will now be subject to this exercise, including EEA branches of institutions that have their head office in third countries. The new rules entered into force on November 7, 2014.

The Policy Statement is available at:

<http://www.bankofengland.co.uk/pr/ Documents/publications/ps/2014/ps1114.pdf>.

Financial Stability Board Publishes Third Progress Report on Implementation of Principles for Sound Compensation Practices

On November 4, 2014, the Financial Stability Board (“FSB”) issued a third progress report on the implementation of its Principles for Sound Compensation Practices and their Implementing Standards (“P&S”). The Principles are aimed at all significant financial institutions, especially systemically important institutions, to bring compensation practices in line with prudent risk-taking. The Implementation Standards are intended to strengthen FSB jurisdictions’ adherence to the Principles. The FSB report deals with remaining implementation gaps, and its main findings are that: (i) implementation is generally complete although the P&S do not apply or are incompatible with certain jurisdictions, and in such cases, the FSB recommends that appropriate action is taken to address any possible risks in those jurisdictions; (ii) supervision of compensation practices by regulatory authorities has generally improved, though different methods of supervision are used across various jurisdictions, and areas that could be improved have been identified, such as compensation governance and the identification of material risk takers; and (iii) the level of implementation by significant banks has generally been assessed by national regulators to be medium or high. The FSB will organize

a roundtable meeting in early 2015 to discuss trends and views on the implementation process, and any remaining challenges.

The report is available at: http://www.financialstabilityboard.org/wp-content/uploads/r_141104.pdf.

Consumer Protection

Shared National Credits Review and Supplemental Report on Leveraged Lending

On November 7, 2014, the US Office of the Comptroller of the Currency (“OCC”), the Federal Reserve Board, and the Federal Deposit Insurance Corporation (“FDIC”) released the annual Shared National Credits (“SNC”) review and a supplemental report on leveraged lending. The review found that the credit quality of large loan commitments owned by US banking organizations, FBOs, and nonbanks is generally unchanged in 2014 from the prior year. The supplemental report on leveraged lending highlighted deficiencies in underwriting standards and risk management of leveraged loans. Leveraged loans as reported by agent banks totaled \$767 billion, or 22.6 percent of the 2014 SNC portfolio.

Federal banking regulations require institutions to engage in sound practices when involved in commercial lending activities, including leveraged lending. Regulators are looking to increase the frequency of leveraged lending reviews to ensure the level of risk is identified and managed.

The SNC Review is available at:

<https://www.fdic.gov/news/news/press/2014/pr14096a.pdf>, the Leveraged

Lending Supplement is available at:

<https://www.fdic.gov/news/news/press/2014/pr14096b.pdf> and the Leverage

Lending FAQ is available at:

<https://www.fdic.gov/news/news/press/2014/pr14096FAQ.pdf>.

EBA Consults on Methods for Calculating Contributions to Deposit Guarantee Schemes

On November 10, 2014, the European Banking Authority (“EBA”) issued a consultation paper on its draft guidelines on methods for calculating contributions to Deposit Guarantee Schemes (“DGSs”). The consultation sets out proposed principles and elements to calculate risk-based contributions to DGSs, and seeks views on setting up sound methods for the calculation of risk-based contributions. The guidelines propose to incentivize institutions to operate under less risky business models. The guidelines also run through various aspects of risk profiles, by listing risk indicators relating to capital, liquidity and funding, asset quality, business model and management, and potential losses for DGSs. The consultation closes on February 11, 2015.

The consultation paper is available at:

<http://www.eba.europa.eu/documents/10180/887892/EBA-CP-2014-35+Draft+CP+on+GL+on+DGS+Contributions.pdf>.

Derivatives

Commodity Futures Trading Commission Staff Provide Time-Limited No-Action Relief for Certain Affiliated Counterparties

On November 7 2014, the US Commodity Futures Trading Commission (“CFTC”) Divisions of Clearing and Risk (“DCR”) and Market Oversight (“DMO”) each extended previously-issued no-action relief for certain inter-affiliate transactions. No-action relief that was previously provided in DCR No-Action Letter 14-25 and DMO No-Action Letter 14-26 is being extended until December 31, 2015. Eligible Affiliate Counterparties must satisfy all of the requirements of CFTC regulation 50.52 to be eligible for this relief. Additionally, a counterparty to the swap cannot be located in a non-US jurisdiction for which the CFTC has not determined that a comparable and comprehensive clearing requirement exists. Finally Eligible Affiliate Counterparties opting for this relief must provide, upon request, documentation regarding their compliance with this no-action letter along with regulation 50.52 to the DCR. The CFTC believes that this extension will permit a smooth transition as jurisdictions continue to establish and implement clearing requirements.

The CFTC Staff Letter No. 14-135 providing extension to No-action Letter 14-25 is available at:

<http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/14-135.pdf> and CFTC Staff Letter No. 14-136 providing extension to No-action Letter 14-26 is available at:
<http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/14-136.pdf>.

Consultation on Amending EU Technical Standards for the OTC Derivatives Reporting Obligation

On November 10, 2014, the European Securities and Markets Authority (“ESMA”) published a consultation paper on its review of the technical standards on reporting obligations under the European Market Infrastructure Regulation (“EMIR”). The technical standards are: (i) RTS on the minimum details of the data to be reported to trade repositories; and (ii) implementing technical standards on the format and frequency of trade reports to trade repositories. ESMA explains that the technical standards were developed before any real practical experience could be used to formulate the requirements and therefore the update is needed to clarify some issues and ensure a more consistent and harmonized approach across the EU. ESMA is proposing to amend the above standards to reflect the clarifications which have been set out in its EMIR Q&As as well as other practical insight gained since the secondary legislation came into effect by: (i) clarifying data fields and their descriptions; (ii) adapting existing fields to the reporting logic prescribed in the Q&As or to reflect specific ways of populating those fields; and (iii) introducing new fields and values to reflect market practice or regulatory requirements. The consultation closes on February 13, 2015. ESMA will use the feedback to prepare final draft amending standards for submission to the European Commission.

The consultation paper is available at: <http://www.esma.europa.eu/news/ESMA-consults-revised-EMIR-standards-reporting-trade-repositories?t=326&o=home>.

Financial Stability Board Report on Progress on Implementing Derivatives Reforms

On November 7, 2014, the FSB published its Eighth Progress Report on Implementation of OTC Derivatives Market Reforms. The Report provides an update ahead of the G20 Summit on November 15 and 16, 2014 on progress made by the 19 FSB member jurisdictions. The Report includes tables illustrating compliance by the jurisdictions in the key areas of trade reporting, clearing, margin and capital for uncleared derivatives and executing trades on exchanges or other trading venues.

The report is available at: <http://www.financialstabilityboard.org/wp-content/uploads/8th-OTC-derivatives-progress-report-for-publication-7Nov.pdf>.

Report on Cross-Border Implementation Issues for OTC Derivatives Reforms

On November 7, 2014, the OTC Derivatives Regulators Group (“ODRG”) published a report to the G20 Leaders setting out the progress made in identifying and resolving cross-border implementation issues of OTC derivatives reforms. The ODRG was set up to help resolve conflicts, inconsistencies, gaps and duplicative requirements across jurisdictions.

The report is available at: <http://www.esma.europa.eu/content/Report-OTC-Derivatives-Regulators-Group-ODRG-G20-Leaders-Cross-Border-Implementation-Issues>.

OTC Derivatives Regulator’s Forum Publishes Revised Documentation

On November 5, 2014, the OTC Derivatives Regulator’s Forum published the following two documents, both dated May 2014:

1. Revised framework for information sharing and cooperation among OTC derivatives regulators; and
2. Terms of reference for a trade repository technical working group.

Both documents are available at:
http://www.otcdrf.org/list/otcdrf_documents/index.htm.

Enforcement

Commodity Futures Trading Commission Releases Annual Enforcement Results for Fiscal Year 2014

On November 6, 2014, the US CFTC reported on the agency’s enforcement results for fiscal year 2014. The CFTC imposed a record \$3.27 billion in monetary sanctions against certain companies and individuals. In addition to dealing with outstanding cases filed in prior years the CFTC has also filed 67 new enforcement actions.

2014 CFTC enforcement highlights are available at:

<http://www.cftc.gov/PressRoom/PressReleases/pr7051-14>.

Former Execution Trader Pleads Guilty to Insider Dealing

On November 7, 2014, in a UK case brought by the FCA, Julian Rifat, former execution trader at Moore Capital Management LLC, pleaded guilty to insider dealing following Operation Tabernula, the largest and most complex investigation led by the FCA to date. Julian Rifat is due to be sentenced in 2015.

Financial Services

UK Government Issues Call for Information on Digital Currencies

On November 3, 2014, the UK government launched a call for information on the benefits and risks of digital currencies. Bitcoins are the most well-known type of digital currency although others are in circulation. The UK government would like to support innovation in the financial technology area but at the same time wishes to assess whether action is required to mitigate risks associated with any such innovation. The call for information focuses on digital currencies as a means of payment instead of as a speculative investment. The consultation closes on December 3, 2014.

The call for information is available at:

<https://www.gov.uk/government/consultations/digital-currencies-call-for-information>.

Funds

European Securities and Markets Authority Calls for Evidence on Extending the AIFMD Passport to Third Country Fund Managers

On November 7, 2014, ESMA published a call for evidence to inform its preparation of: (i) an opinion on the functioning of the passport for EU alternative investment fund managers (“AIFMs”) and the national private placement regime for non-EU AIFMs; and (ii) advice on the application of the passport to non-EU AIFMs and alternative investment funds (“AIFs”). Both the opinion and the advice are required to be provided by ESMA to the European Parliament, Council of the European Union and the European Commission by July 22, 2015 under the Alternative Investment Fund Managers Directive (“AIFMD”). Under the AIFMD, non-EU AIFMs and non-EU AIFs managed by EU AIFMs are subject to the national private placement regime in each Member State that an AIF is marketed or managed. If ESMA provides positive advice, the European Commission is obligated to adopt legislation extending the EU passport to non-EU AIFs and non-EU AIFMs. To provide positive advice, ESMA must be convinced that “no significant obstacles regarding investor protection, market disruption, competition and the monitoring of systemic risk” would hinder the extension of the passport. ESMA’s advice will distinguish between countries so that only funds or managers

of non-EU countries that satisfy the criteria will benefit from the passport. The consultation closes on January 8, 2015.

The call for evidence is available at: <http://www.esma.europa.eu/news/ESMA-consults-AIFMD-passport-and-third-country-AIFMs?t=326&o=home>.

Recovery & Resolution

European Banking Authority Proposals on Contractual Recognition of Bail-in

On November 5, 2014, the EBA published its proposed RTS required under the Banking Recovery and Resolution Directive (“BRRD”) to specify when the contractual recognition of bail-in is required and the contents of the term itself. Under the BRRD, EU resolution authorities will have powers to write-down and convert certain liabilities of an investment firm or bank during resolution of that firm. To ensure that those powers are effective cross-border, firms will be required to include a contractual term in relevant agreements governed by the law of a non-EU member state which obliges the creditor to recognize that it may be subject to a write-down or conversion powers and to agree to be bound by the reduction of the principal or outstanding amount due, conversion or cancellation that is put in place.

The proposed RTS set out a minimum a list of factors which need to be present for an EU resolution authority to determine that its bail-in powers may be exercised under the law of a third country or under an agreement with the relevant third country. The proposed draft RTS also include a list of mandatory elements for inclusion in the contractual term required under the BRRD, such as express acknowledgement of and consent to the application of the bail-in powers. Under the BRRD, the requirement to include the contractual term applies to liabilities issued or entered into after a member state has adopted provisions to transpose the relevant section of the BRRD. Member states are required to transpose the BRRD into national laws by December 31, 2014. However, the bail-in provisions need only apply from January 1, 2016. The EBA is proposing that liabilities subject to the contractual requirement include: (i) liabilities under agreements entered after the relevant transposition date; (ii) liabilities under agreements created after the transposition date under agreements entered into before that date; (iii) liabilities under agreements entered into before the transposition date but amended after that date; and (iv) liabilities under debt instruments issued after the transposition date, including programs existing prior to the transposition date. The EBA’s consultation closes on February 5, 2015.

The EBA consultation paper is available at:

<http://www.eba.europa.eu/documents/10180/882606/EBA-CP-2014-33+%28Draft+CP+on+RTS+on+contractual+recognition+of+bail-in%29.pdf>.

European Banking Authority Proposes Draft Standards for Valuations under BRRD

On November 10, 2014, the EBA published proposed draft RTS on valuation in recovery and resolution for consultation. Under the BRRD, independent

valuations are required both before and after resolution of a firm to inform the decisions of resolution authorities. Before resolution, valuations are required to assess whether the conditions for resolution or bail-in are met and assist in determining which resolution action should be adopted and the extent of any bail-in. Valuations are required after resolution to determine whether a firm's shareholders or creditors would have received more advantage if normal insolvency proceedings were used. The EBA has prepared two proposed draft RTS, for before and after resolution. The consultation closes on February 6, 2015.

The consultation paper is available at:

<http://www.eba.europa.eu/documents/10180/886895/CP+on+draft+RTS+on+valuation++EBA-CP-2014-38.pdf>.

Financial Stability Board Consults on TLAC for G-SIBs

On November 10, 2014, the FSB launched a consultation on policy proposals for enhancing the loss-absorbing capacity G-SIBs. The proposals comprise (i) principles on the loss absorbing and recapitalization capacity of G-SIBs in resolution; and (ii) a term sheet on Total Loss Absorbency Capital ("TLAC") for implementing the principles as an internationally agreed standard. The FSB is proposing to introduce a new minimum Pillar 1 requirement for TLAC on a going concern and gone concern basis which incorporates the existing Basel III minimum requirements but excludes the Basel III capital buffers. The aim of the development of the new standard, prepared by the FSB with the Basel Committee, is to ensure that G-SIBs can be resolved without resorting to taxpayer funding, with a minimum impact on financial stability and ensuring continuity of critical services. It is intended that the TLAC proposals will be finalized before the G20 Leaders meeting in 2015. Responses to the consultation are due by February 2, 2015.

The consultation paper is available at: <http://www.financialstabilityboard.org/wp-content/uploads/TLAC-Condoc-6-Nov-2014-FINAL.pdf>.

People

Mark Carney Reappointed as Financial Stability Board Chairman

On November 4, 2014, Mark Carney was reappointed as FSB Chairman for a second term of three years.

Events

December 2, 2014: the US OCC, the Federal Reserve Board, and the FDIC will hold the first in a series of outreach meetings on the agencies' interagency effort to reduce regulatory burden as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996.

November 13, 2014: the US House Committee on Financial Services will hold a hearing entitled "Terrorist Financing and the Islamic State."

January 8, 2015: EBA open hearing on draft guidelines on methods for calculating contributions to DGSs.

January 9, 2015: EBA open hearing on RTS on contractual recognition of bail-in under the BRRD.

January 16, 2015: EBA open hearing on RTS valuation in recovery and resolution.

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

London

AZAD ALI

T: +44 20 7655 5659

azad.ali@shearman.com

London

AATIF AHMAD

T: +44 20 7655 5120

aatif.ahmad@shearman.com

London

OLIVER LINCH

T: +44 20 7655 5715

oliver.linch@shearman.com

London

THOMAS DONEGAN

T: +44 20 7655 5566

thomas.donegan@shearman.com

London

JOHN ADAMS

T: +44 20 7655 5740

john.adams@shearman.com

London

ANNA DOYLE

T: +44 20 7655 5978

anna.doyle@shearman.com

London

ELLIE TEO

T: +44 20 7655 5070

ellerina.teo@shearman.com

London

BILL MURDIE

T: +44 20 7655 5149

bill.murdie@shearman.com

London

KOLJA STEHL

T: +49 69 9711 1623

kolja.stehl@shearman.com

Frankfurt / London

MAK JUDGE

T: +44 20 7655 5182

mak.judge@shearman.com

London / Singapore

JAMES CAMPBELL

T: +44 20 7655 5570

james.campbell@shearman.com

London

AMERICAS

DONALD N. LAMSON

T: +1 202 508 8130

donald.lamson@shearman.com

Washington, DC

BRADLEY K. SABEL

T: +1 212 848 8410

bsabel@shearman.com

New York

SYLVIA FAVRETTO

T: +1 202 508 8176

sylvia.favretto@shearman.com

Washington, DC

RUSSELL D. SACKS

T: +1 212 848 7585

rsacks@shearman.com

New York

REENA AGRAWAL SAHNI

T: +1 212 848 7324

reena.sahni@shearman.com

New York

JENNIFER D. MORTON

T: +1 212 848 5187

jennifer.morton@shearman.com

New York

DONNA M. PARISI

T: +1 212 848 7367

dparisi@shearman.com

New York

TIMOTHY J. BYRNE

T: +1 212 848 7476

tim.byrne@shearman.com

New York

CHRISTINA BROCH

T: +1 202 508 8028

christina.broch@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

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.

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.