

Financial Regulatory Developments Focus



In this issue:

Bank Prudential
Regulation & Regulatory
Capital

Derivatives

Financial Market
Infrastructure

Financial Services

Funds

Recovery & Resolution

Shadow Banking

Events

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

Bank Prudential Regulation & Regulatory Capital

The Federal Reserve Board Proposes Enhanced Prudential Oversight for General Electric's Financial Arm

On November 25, 2014, the US Board of Governors of the Federal Reserve System ("Federal Reserve Board") issued a proposed order to apply enhanced prudential standards to General Electric Capital Corporation ("GECC"), the financial arm of General Electric. The Financial Stability Oversight Council ("FSOC") has designated GECC as systemically important under Section 165 of the Dodd-Frank Act. The enhanced prudential standards would be similar to those standards applicable to large bank holding companies and would include requirements for risk-based capital, leverage, liquidity, stress testing and other prudential standards.

Certain additional standards specific to GECC's activities would also be applied, including restricting transactions between General Electric Corporation and GECC and independence requirements for the board of directors of GECC. There is a 60 day consultation period.

The Federal Reserve Board proposed order is available at:

<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20141125b1.pdf>.

Federal Deposit Insurance Corporation Issues Filing and Document Procedures for State Banks

On November 19, 2014, the Federal Deposit Insurance Corporation ("FDIC") issued a Financial Institution Letter ("FIL") applicable to all state banks outlining documentation and filing procedures for state banks engaging, directly or indirectly, in investments and activities permissible for national banks.

The FDIC FIL is available at:

<https://www.fdic.gov/news/news/financial/2014/fil14054.pdf>.

Federal Deposit Insurance Corporation Issues Guidance for Deposit Insurance

On November 20, 2014, the FDIC issued a FIL laying out guidance in the form of questions and answers for new banks preparing applications for deposit insurance. The guidance is applicable to institutions with \$1 billion or less in consolidated assets and covers topics including, among other things, processing timelines, pre-filing meetings and initial capitalization.

The FDIC FIL is available at:

<https://www.fdic.gov/news/news/financial/2014/fil14056a.pdf>.

Federal Deposit Insurance Corporation Issues Final Rule Revising Capital Ratios

On November 25, 2014, the FDIC issued a final rule which will revise capital ratios and ratio thresholds to conform to the prompt corrective action capital ratio and ratio thresholds for used deposit insurance assessments. It will further revise assessment base calculations and require “highly complex” institutions to use Basel III standardized approaches for derivatives and securities financing transactions to measure counterparty exposure for deposit insurance assessment. The final rule will be effective on January 1, 2015, except for certain amendments to 12 C.F.R. § 327.9 of certain assessment pricing methods, which will be effective on January 1, 2018.

The final rule is available at: <http://www.gpo.gov/fdsys/pkg/FR-2014-11-26/pdf/FR-2014-11-26.pdf>.

Federal Deposit Insurance Corporation Issues Proposed Rule Amending Filing Requirements

On November 25, 2014, the FDIC issued a proposed rule to amend filing requirements and processing procedures for notices filed under the Change in Bank Control Act. The rule would, among others, consolidate requirements and adopt best practices of the Federal Reserve Board and the OCC. The rule, if finalized, will be effective January 25, 2015.

The proposed rule is available at: <http://www.gpo.gov/fdsys/pkg/FR-2014-11-25/pdf/2014-27934.pdf>.

Prudential Regulation Authority Proposes Revised LCR Regime

On November 28, 2014, the UK Prudential Regulation Authority (“PRA”) launched a consultation on the UK liquidity coverage requirement (“LCR”) framework. EU secondary legislation implementing LCR requirements across the EU will come into force by December 31, 2014 and will apply in the UK from October 1, 2015. The PRA is therefore proposing to: (i) revoke the current UK LCR rules; (ii) apply a transition to 100% LCR on January 1, 2018 by requiring 80% LCR from October 1, 2015 and 90% from January 1, 2017; (iii) continue existing add-ons not covered in the EU LCR regime as new Pillar 2 add-ons until each firm’s next liquidity review; (iv) maintain the current reporting regime for two years following the introduction of the COREP liquidity returns in 2015;

(v) require firms to ensure that their systems and processes enable them to report all COREP liquidity returns daily; (vi) extend the EU LCR rules to UK-designated investment firms; and (vii) require third country firms to provide liquidity information on a whole-firm basis. The proposals are relevant to UK banks, building societies and UK-designated investment firms as well as UK branches of EEA credit institutions and third country banks or designated investment firms. The consultation closes on February 27, 2015.

The consultation paper is available at:

<http://www.bankofengland.co.uk/pr/Documents/publications/cp/2014/cp2714.pdf>.

Derivatives

Commodity Futures Trading Commission Issues No-Action Relief for Family Offices from Registration as Commodity Trading Advisor

On November 25, 2014, the US Commodity Futures Trading Commission (“CFTC”) issued no-action relief for family offices from commodity trading adviser registration, for advisory services they offer to family clients. To be eligible for this relief, a family office must remain in compliance with the exclusion for family offices from the definition of investment adviser adopted by the Securities and Exchange Commission (“SEC”). This relief is not self-executing. Therefore, a family office must file a claim with the CFTC to elect this relief.

CFTC Staff Letter 14-143 is available at:

<http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/14-143.pdf>.

Commodity Futures Trading Commission Issues No-Action Letter for Treasury Affiliates

On November 26, 2014, the CFTC issued a no-action letter modifying relief that was previously issued for treasury affiliates in June 2013 in CFTC No-Action Letter 13-22. Similar to No-Action Letter 13-22, this letter provides relief from required clearing for “eligible treasury affiliates” that are wholly owned by a non-financial parent company and are defined as “financial entities” under the Commodity Exchange Act, due to the activities undertaken on behalf of its non-financial affiliates. The new letter makes several changes to the June 2013 letter, including amendments to requirements imposed on operations between a treasury affiliate and its affiliates, removal of restrictions as to the number of financial affiliates that may be within a corporate group and permission for treasury entities affiliated with non-bank financial companies designated as systemically important to elect relief subject to certain conditions.

CFTC Staff Letter 14-144 is available at:

<http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/14-144.pdf>.

Financial Market Infrastructure

Proposed Guidance on Trade Process Requirements for UK MTFs

On December 1, 2014, the UK Financial Conduct Authority (“FCA”) published proposed guidance on MTF trade process requirements under the FCA’s rules. The proposed guidance consists of a Dear CEO letter and Good Practice Observations. The proposed guidance follows a FCA thematic review of MTF operators’ rulebooks to assess compliance with trade process requirements. The consultation closes on January 16, 2015.

The consultation paper is available at:

<http://www.fca.org.uk/static/documents/guidance-consultations/gc14-09.pdf>.

Financial Services

Prudential Regulation Authority Proposes Further Rulebook Amendments

On November 24, 2014, the PRA published a consultation paper setting out further proposals on how the regulator intends to redraft the PRA Handbook. The PRA began work in January 2014 on reshaping Handbook material inherited by it from the Financial Services Authority so as to create a separate PRA-only Rulebook. The PRA Rulebook, although not yet complete, currently appears on the existing handbook website in PDF form but will move to a new online site in mid-2015. The PRA Rulebook will set out the core rules and directions applicable to firms regulated by the PRA. Handbook guidance will either move into supervisory statements, policy statements or appear on the PRA website (the latter is intended for process-related materials). The current consultation covers status disclosure, controllers, close links, notifications and systems and controls, governance and transfers of insurance business.

The consultation paper is available at:

<http://www.bankofengland.co.uk/pr/Documents/publications/cp/2014/cp2514.pdf>.

International Organization of Securities Commissions Consults on Cross-Border Regulatory Tools

On November 25, 2014, the International Organization of Securities Commissions (“IOSCO”) published a consultation paper on cross-border regulatory tools and challenges. The report describes three tools that may be used by national regulators considering cross-border regulation, classified by IOSCO into National Treatment, Passporting and Recognition. The consultation is open until February 23, 2015.

The consultation paper is available at:

<https://www.iosco.org/library/pubdocs/pdf/IOSCOPD466.pdf>.

Funds

European Securities & Markets Authority Consults on Guidelines for Asset Segregation under AIFMD

On December 1, 2014, the European Securities and Markets Authority (“ESMA”) published proposed guidelines on the asset segregation requirements when safe-keeping duties are delegated by the depository of an alternative investment fund (“AIF”) under the Alternative Investment Fund Managers Directive. The third party to which safe-keeping of an AIF’s assets is delegated is under a duty to segregate those assets from its own assets, the assets of its other clients, the delegating depositaries own assets and assets of clients of the depository which are not AIFs. Therefore an account for AIF assets only must be held by the third party. ESMA is seeking to address the question of whether the assets held in such an AIF asset account can only be assets which come from the same delegating depository or whether the AIF asset account can hold AIF assets from different delegating depositaries. ESMA is proposing that the guidelines, once finalized, would apply to Alternative Investment Fund Managers, depositaries of AIFs and national regulators. The consultation closes on January 30, 2015.

The consultation paper is available at:

<http://www.esma.europa.eu/consultation/Consultation-Guidelines-asset-segregation-under-AIFMD>.

Final Advice on Insolvency Protections and Independence Under UCITS V Directive Submitted to the European Commission

On November 28, 2014, ESMA published its final advice to the European Commission on the content of secondary legislation on depositaries required under the Undertakings for Collective Investment in Transferable Securities (“UCITS”) V Directive. The advice covers insolvency protection of UCITS assets when safekeeping of assets is delegated and proposes measures, arrangements and tasks for the third party to which a depository delegates custody and measures for the depository to put in place. The advice also proposes measures for investment companies, management companies and depositaries to put in place to ensure that they each act independently, as required under UCITS V.

The advice is available at: <http://www.esma.europa.eu/news/ESMA-submits-advice-delegated-acts-required-UCITS-V-Directive?t=326&o=home>.

Recovery & Resolution

The Federal Reserve Board Provides Feedback on Wells Fargo’s Second “Living Will”

On November 25, 2014, the Federal Reserve Board and the FDIC issued a joint letter to Wells Fargo upon completion of their review of the firm’s 2014 resolution plan, commonly referred to as the “living will.” The living will is a plan for an orderly resolution strategy in the case of material financial distress or

failure of the firm. The Federal Reserve Board and FDIC noted that Wells Fargo had improved the narrative of its preferred resolution strategy and made progress in addressing five obstacles identified by the agencies in previous guidance. The agencies also announced that three banks, BNP Paribas, HSBC and Royal Bank of Scotland, will be required to submit their living wills on December 31, rather than July 1, beginning in 2015.

The Federal Reserve Board press release is available at:

<http://www.federalreserve.gov/newsevents/press/bcreg/20141125a.htm>.

European Banking Authority Proposes Draft RTS Relating to MREL Criteria

On November 28, 2014, the European Banking Authority (“EBA”) published proposed draft regulatory technical standards (“RTS”) to further specify the criteria to be applied by national resolution authorities when setting a firm’s minimum requirement for own funds and eligible liabilities (“MREL”). The Banking Recovery and Resolution Directive (“BRRD”) requires firms to meet a MREL, which is to be set on a firm-by-firm basis by national resolution authorities. The MREL is intended to prevent firms from structuring their liabilities to hinder or delay the effectiveness of the bail-in or other resolution tools. The BRRD sets out certain criteria to be taken into account by resolution authorities when setting a firm’s MREL. The proposed draft RTS provide further details as to those criteria, aiming to ensure convergence on the application of the BRRD criteria across the EU so that firms with similar risk profiles and resolvability in any Member State have similar levels of MREL. Responses to the consultation are due by February 27, 2015.

The consultation paper is available at:

<http://www.eba.europa.eu/documents/10180/911034/EBA+CP+2014+41+%28CP+on+draft+RTS+on+MREL%29.pdf>.

ISDA Publishes Principles for CCP Recovery Published

On November 25, 2014, the International Swaps and Derivatives Association (“ISDA”) published the ISDA Principles for CCP Recovery. ISDA considers that clearing houses have become systemically important and that the risk of a clearing house reaching the point of non-viability should be minimized. ISDA’s principles for CCP Recovery cover: (i) transparent risk management standards, practices and methodologies; (ii) mandatory, standardized and transparent stress testing; (iii) skin in the game; (iv) clearly defined CCP recovery plans; and (v) clearing service termination or resolution.

The ISDA principles are available at: <http://www2.isda.org/functional-areas/risk-management/>.

Shadow Banking

European Banking Authority Opines on Interpretation of "Credit Institution"

On November 27, 2014, the EBA published an opinion and report on the perimeter of credit institutions. The EBA recommends that the definition of "credit institutions", which is set out in the Capital Requirements Regulation but also used in other key legislation such as the BRRD, should be clarified by development of definitions of the terms "deposit" and "other repayable funds" as included in the CRR definition. The definition is important because the term "credit institutions" has been interpreted differently in EU member states. This means that an entity may be regulated in one Member State but would not be regulated in another Member State. The work forms part of the EU's assessment of the shadow banking arena and consideration of what, if any, further steps should be taken to curb risks arising from shadow banking activities.

The EBA, in April 2014, provided its preliminary findings on the various interpretations across the EU member states of the term "credit institution." Since then, the EBA has assessed the EU-established entities that are not credit institutions, are not otherwise subject to solo prudential requirements and which carry on bank-like activities under the scope of credit intermediation. The EBA notes the difference in treatment of such entities by member states and suggests that the European Commission may like further analysis of the sector carried out before determining whether EU legislation is required to regulate the sector.

The EBA opinion is available at:

<http://www.eba.europa.eu/documents/10180/657547/EBA-Op-2014-12+%28Opinion+on+perimeter+of+credit+institution%29.pdf> and the report is available at: <http://www.eba.europa.eu/documents/10180/534414/2014+11+27+-+EBA+Report+-+Credit+institutions.pdf>.

Events

December 5, 2014: EBA public hearing on the conclusions and policy recommendations included in the draft Credit Valuation Adjustment report.

January 19, 2015: EBA public hearing on criteria for setting the minimum requirement for own funds and eligible liabilities under the Banking Recovery & Resolution Directive.

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

ELLIE TEO

T: +44 20 7655 5070

ellerina.teo@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

JAMES CAMPBELL

T: +44 20 7655 5570

james.campbell@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

OLIVER LINCH

T: +44 20 7655 5715

oliver.linch@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.