



## Financial Regulatory Developments Focus

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

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## Bank Prudential Regulation & Regulatory Capital

### US Office of the Comptroller of the Currency Releases Risk Appetite Statement

On April 12, 2016, the US Office of the Comptroller of the Currency released its Risk Appetite Statement, which documents the OCC's overall conservative risk appetite in carrying out its supervisory mission. The Risk Appetite Statement provides that the OCC will accept more risk in some areas in order to adapt to the changing needs of supervised national banks and federal savings associations. OCC management and employees will use the statement to evaluate their decisions in overseeing national banks and federal savings associations as well as the execution of agency management functions, such as human resources, procurement and information technology.

Comptroller of the Currency Thomas J. Curry noted that by clearly articulating acceptable levels of risks within the OCC's operations, agency personnel have "clearer signposts by which to guide their decisions and external stakeholders can better understand OCC actions in the context of the risks facing the agency." The OCC plans to update its Risk Appetite Statement periodically as the federal banking system and its supervision evolve.

The OCC's Risk Appetite Statement is available at: <http://www.occ.gov/publications/publications-by-type/other-publications-reports/risk-appetite-statement.pdf>.

### US Financial Stability Oversight Council Files Appeal to MetLife Decision

On April 8, 2016, the US Financial Stability Oversight Council filed its appeal to the DC District Court opinion overturning the FSOC's designation of insurer MetLife as a systemically important financial institution. In the March 30, 2016 judicial opinion that was unsealed last week, US District Court Judge Rosemary Collyer called the FSOC's determination process "fatally flawed" and "arbitrary and capricious," ruling that the FSOC did not follow its own guidelines before deciding on the Metlife designation. US Treasury Secretary Jacob J. Lew has criticized the court's ruling, arguing that by overturning the conclusions of experienced financial regulators, "the court imposed new requirements that Congress never enacted, and contradicted key policy lessons from the financial crisis."

The US District Court opinion is available at: <https://www.scribd.com/doc/307428677/MetLife-vs-FSOC-U-S-District-Court-for-D-C> and the statement from Treasury Secretary Jacob J. Lew is available at: <https://www.treasury.gov/press-center/press-releases/Pages/jl0410.aspx>.

### US Board of Governors of the Federal Reserve System Proposes Technical Amendments to Risk-Based Capital Surcharge for Global Systemically Important Bank Holding Companies

On April 7, 2016, the US Board of Governors of the Federal Reserve System proposed technical amendments to its rule requiring a risk-based capital surcharge for global systemically important bank holding companies. The rule, finalized by the Federal Reserve Board in July 2015, establishes the criteria for identifying a GSIB and the methodology a GSIB is required to use to determine its risk-based capital surcharge, which corresponds to the systemic risk of that firm.

The proposed amendments would not materially change the underlying final rule but rather clarify that GSIBs must continue to calculate their surcharges using year-end data, while their related surcharge data will be reported on a quarterly basis. The proposal explains that bank holding companies subject to the rule are required to compute their method 2 surcharge scores using systemic indicator amounts expressed in billions of dollars even though the data is reported in millions of dollars. The amendments also provide additional information on how GSIBs should calculate their short-term wholesale funding scores, which help to determine their surcharges, during the rule's transition period.

Comments on the proposal are due by May 13, 2016.

The Federal Reserve Board press release is available at: <http://www.federalreserve.gov/newsevents/press/bcreg/20160407a.htm> and the proposal is available at: <https://www.gpo.gov/fdsys/pkg/FR-2016-04-08/pdf/2016-08015.pdf>.

### **US Federal Reserve Board Issues Guidance on Basel Committee Consultation on Operational Risk Measurement**

On April 6, 2016, the Federal Reserve Board's Division of Banking Supervision and Regulation and Basel Coordination Committee issued a bulletin that provides supervisory guidance with respect to the issuance of the Basel Committee on Banking Supervision's second consultative paper published on March 4, 2016, "Standardised Measurement Approach for Operational Risk."

The BCBS paper proposes certain revisions applicable to large, internationally active banking organizations, including a non-model-based method for calculating operational risk-weighted assets and a withdrawal of the advanced measurement approaches (AMA) for operational risk from the Basel capital framework. In its bulletin, the Federal Reserve Board states that it will consider the BCBS proposals in connection with the US advanced approaches risk-based capital rule in a manner consistent with the US notice and comment process, during which time the existing AMA capital requirements will remain in effect.

The Federal Reserve Board guidance is available at: <http://www.federalreserve.gov/bankinforeg/basel/files/bcc1601.pdf>.

### **US Federal Reserve Board Proposes New Data Items for Regulatory Reporting by Foreign Banking Organizations**

On April 4, 2016, the Federal Reserve Board proposed changes to various reporting forms, including FR Y-7N, FR Y-7NS and FR Y-7Q, requiring collection of fourteen new data items to monitor compliance with enhanced prudential standards for foreign banking organizations. The new data items, adopted pursuant to Subparts N and O of Regulation YY, would be used to determine whether an FBO with total consolidated assets of \$50 billion or more meets capital adequacy standards at the consolidated parent company level that are consistent with the Basel capital framework.

The proposed revisions would be effective September 30, 2016, and, for certain items, March 31, 2018. Comments to the Federal Reserve Board proposal are due by June 3, 2016.

The proposal is available at: <https://www.gpo.gov/fdsys/pkg/FR-2016-04-04/pdf/2016-07545.pdf>.

### **US Federal Reserve Board Staff Working Paper Concludes Both Capital and Liquidity Need to be Regulated**

In early April, the Federal Reserve Board's Divisions of Research and Statistics and Monetary Affairs released a staff working paper entitled "Bank Regulation under Fire Sale Externalities," addressing the optimal design of, and interaction between, capital and liquidity regulations in a model characterized by fire sale externalities. In particular, the authors analyze whether it suffices to introduce capital regulations alone and let banks freely choose their liquidity ratios or whether liquidity also needs to be regulated. The results of the study indicate that the pre-Basel III regulatory framework, with its reliance only on capital requirements, was inefficient and ineffective in addressing systemic instability caused by fire sales. The paper notes that capital requirements can lead to less severe fire sales by forcing banks to reduce risky assets, however, it also shows that banks respond to stricter capital requirements by decreasing their liquidity ratios. Anticipating this response, the regulator preemptively sets capital ratios at high levels and ultimately, this interplay between banks and the regulator leads to inefficiently low levels of risky assets and liquidity. The paper concludes that macroprudential liquidity requirements that complement capital regulations, as in Basel III, restore constrained efficiency, improve financial stability and allow for a higher level of investment in risky assets.

The Federal Reserve Board staff working paper is available at:  
<http://www.federalreserve.gov/econresdata/feds/2016/files/2016026pap.pdf>.

### **Federal Reserve Bank of New York Releases Report on Organization of Global Banks**

In early April, the Federal Reserve Bank of New York released a staff report entitled "Organizational Complexity and Balance Sheet Management in Global Banks," which analyzes the evolution of banks from standalone institutions to being subsidiaries of complex financial conglomerates. The paper suggests the organizational complexity of the family

of a bank is a fundamental driver of the business model of the bank itself, as reflected in the management of the bank's own balance sheet. Based on microdata on global banks with branch operations in the United States, the report shows that branches of conglomerates in more complex families have a markedly lower lending sensitivity to funding shocks. The balance sheet management strategies of banks are very much determined by the structure of the organizations the banks belong to and the complexity of the conglomerate can change the scale of the lending channel for a large global bank by more than 30 percent.

The New York Fed staff report is available at:

[https://www.newyorkfed.org/medialibrary/media/research/staff\\_reports/sr772.pdf?la=en](https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr772.pdf?la=en).

### **Corrigendum to EU Technical Standards on Supervisory Reporting of Institutions of Liquidity Coverage Arrangements**

On April 9, 2016, a corrigendum relating to the format and frequency of the reporting of liquidity requirements under the Capital Requirements Regulation was published in the Official Journal of the European Union. The corrigendum corrects numerical references to Annexes contained in Commission Implementing Regulation (EU) 2016/322 relating to types of information to be reported and the instructions for reporting.

The corrigendum is available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2016.095.01.0017.01.ENG&toc=OJ:L:2016:095:TOC](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.095.01.0017.01.ENG&toc=OJ:L:2016:095:TOC).

### **European Supervisory Authorities Report on Risks and Vulnerabilities in the EU Financial System**

On April 7, 2016, the European Banking Authority, European Securities and Markets Authority and European Insurance and Occupational Pensions Authority (known as the Joint Committee of the European Supervisory Authorities) published a report identifying three main areas of risk and vulnerability affecting the stability of the EU financial system. The ESAs noted that investment funds had experienced markedly lower returns during the second half of 2015. The ESAs observed that the low interest rate environment, coupled with high non-performing loans ratios in some countries, has contributed to the subdued profitability of banks in the EU. The report concludes that a proactive stance is required to address the high level of non-performing loans at some banks. The report highlighted the trend of increasing interconnectivity of bank and non-bank entities.

The ESAs noted that interconnectedness could act as a potential channel for the propagation of shocks and thereby contribute to negative systematic events. The ESA recommends that the regulators should implement enhanced supervisory monitoring of concentration risks, cross-border exposures and regulatory arbitrage. The ESAs also highlight the risks associated with a potential contagion stemming from China and other emerging markets. Following a decade of strong contributions to global economic growth from emerging economies and China, the recent economic slowdown in these economies could have substantial effects on the EU in future. To forecast the risk in market exposure to these economies, the ESAs suggest that these markets should be covered in risk analysis exercises such as stress test exercises. Supervisors are also asked by the ESAs to carefully evaluate any optimistic assumptions relating to returns on cross-border activity.

The report is available at:

<http://www.eba.europa.eu/documents/10180/1315397/JC+Risks+and+Vulnerabilities+Report+%28JC+2016+17%29%20+Spring+2016.pdf>.

### **European Banking Authority Consults on Amendments to Approaches for Determining Proxy Spreads and Market Loss**

On April 6, 2016, the EBA published a consultation paper proposing amendments to the regulatory technical standards for determining proxy spread and the specification of a limited number of smaller portfolios for credit valuation adjustment risk under the Capital Requirements Regulation. On February 25, 2015, the EBA published a report on the relevance of the RTS provisions. In particular, the EBA focused on a CVA data collection exercise of 32 banks from 11 jurisdictions. The EBA concluded, based on the collection exercise, that there were difficulties in determining

appropriate proxy spreads and market loss given default for a large number of counterparties because spreads may never be observed on markets. The amending RTS provides alternative approaches for the purpose of identifying appropriate proxy spread and market loss given default, in response to the issues outlined in the previous EBA report. The consultation invites responses on whether the amendments address the issues raised in the previous EBA report and whether the amendments are needed. Responses to the consultation are due by July 6, 2016.

The EBA consultation is available at: <http://www.eba.europa.eu/documents/10180/1426637/EBA-CP-2016-04+%28Consultation+Paper+amending+RTS+on+CVA+proxy+spread%29.pdf>.

### **Proposed Revisions to the Basel III Leverage Ratio Framework Published**

On April 6, 2016, the Basel Committee on Banking Supervision published proposals to revise the existing leverage ratio framework. The proposals include amendments to the: (i) measurement of derivative exposures by adopting a modified version of the standardized approach for measuring counterparty credit risk exposures; (ii) treatment of regular-way purchases and sales of financial assets so as to achieve consistency across accounting standards; (iii) treatment of provisions; and (iv) credit conversion factors for off-balance sheet items by aligning them with the standardized approach to credit risk. In addition, the Basel Committee proposes to impose additional requirements on global systemically important banks, setting out options, including whether the additional requirement should apply uniformly to all G-SIBs or be tailored and whether the form should be a higher minimum requirement or a buffer requirement. Responses to the consultation are due by July 6, 2016. The Basel Committee intends to finalize the revised leverage ratio requirement in 2016 so as to allow time for its implementation by January 1, 2018.

The consultation paper is available at: <http://www.bis.org/bcbs/publ/d365.pdf>.

## **Consumer Protection**

### **US Consumer Financial Protection Bureau Director Richard Cordray Presents Agency's Semi-Annual Report to Congress**

On April 7, 2016, US Consumer Financial Protection Bureau Director Richard Cordray presented the CFPB's Semi-Annual Report at a hearing before the Senate Committee on Banking, Housing and Urban Affairs. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the CFPB is required to provide to Congress an update on the CFPB's mission, activities, accomplishments and publications since the last Semi-Annual Report, as well as certain additional information required by the Dodd-Frank Act.

As part of the hearing, Cordray also responded to questions from the Committee, including what standards FinTech companies will be held to since they are not depository institutions. Cordray noted that "it would not be appropriate for new FinTech startups to be getting an advantage in the marketplace because they are arbitraging the regulatory system, they are not complying, they're not taking seriously what the banks and regulated institutions have to do." While many FinTech firms hold "a lot of promise," Cordray added that innovation isn't always a net positive, and cited subprime mortgages as an example of what was once thought of as an innovative product.

At the hearing, Cordray also fielded questions on payday loans, arbitration agreements, prepaid cards and small-business lending. The most contentious interactions involved indirect auto lending and regulation by enforcement.

Cordray's written testimony is available at: <http://www.consumerfinance.gov/newsroom/written-testimony-of-cfpb-director-richard-cordray-before-the-senate-committee-on-banking-housing-and-urban-affairs-20160407/>.

Additional coverage of the hearing is available at:

<http://www.banking.senate.gov/public/index.cfm/hearings?id=106BA9C4-9E02-4CF6-97F8-EEC458DB4D7C>.

## Cyber Security

### Federal Reserve Bank of Boston President Offers Perspectives on Economic and Cyber Risks

On April 4, 2016, while speaking at the Federal Reserve Bank of Boston's 2016 Cybersecurity Conference, Boston Fed President Eric Rosengren addressed risks in the cyber realm, noting that such risks are not abating. In Rosengren's view, banking organizations need to continue to evolve as these risks morph, and as new innovations and expectations of convenience introduce new challenges to security. Rosengren stated, "cyber risks make it imperative that we all work together to ensure that resiliency, monitoring, detection, and recovery capabilities are operational in the financial system."

Rosengren's remarks are available at:

[http://www.bostonfed.org/news/speeches/rosengren/2016/040416/index.htm?wt.source=bfo\\_ers\\_nn](http://www.bostonfed.org/news/speeches/rosengren/2016/040416/index.htm?wt.source=bfo_ers_nn).

### International Report on Cyber Security in Securities Markets

On April 6, 2016, the International Organization of Securities Commissions published a report on cyber security in securities markets from an international perspective. The purpose of the report is to assist IOSCO members and market participants to enhance their cyber security in securities markets. The report outlines from an international perspective the various approaches adopted by market participants and the initiatives implemented by different regulators. The report focuses on the main regulatory challenges associated with cyber security issues across reporting issuers, trading venues, market intermediaries, asset managers and financial market infrastructures. The report states that regulators could cooperate to improve cyber security through the exchange of information on threats, security vulnerabilities and previous cyber-attacks that could ultimately be relevant for other regulated entities and market participants; specifically, information on methods used by cyber criminals, exploited vulnerabilities they are aware of, ways of preventing similar attacks previously committed and emerging cyber risk trends. IOSCO concludes that the fluid nature of securities markets requires market participants and regulators to constantly evolve their responses to cyber security issues.

The IOSCO report is available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD528.pdf>.

## Derivatives

### One-Day Margin Period of Risk for EU Central Counterparty Client Accounts Proposed by European Securities and Markets Authority

On April 5, 2016, ESMA published its final report and amending regulatory technical standards on the margin period for Central Counterparty client accounts. The amending RTS change the time horizons for the liquidation period for gross omnibus accounts and individual segregated accounts for exchange traded derivatives and securities. ESMA considers that a CCP, in a liquidation period, should be able to either transfer or liquidate the position of the defaulting clearing member and furthermore, have sufficient margin to cover exposures arising from such transfer or liquidation.

EMIR is proposing to recognize US clearing houses (Derivative Clearing Organizations) if internal rules and procedures satisfy the following requirements: (i) a minimum liquidation period of two days for initial margin is applied to clearing members' proprietary positions for derivatives contracts executed on regulated markets; (ii) for all derivative contracts, measures are in place to limit procyclicality which are equivalent to the options under EMIR; and (iii) the DCO has sufficient pre-funded available resources enabling it to withstand the default of at least the two clearing members to which it has the largest exposures under extreme conditions.

Following the adoption by the European Commission of an equivalence determination, the US regulatory framework for derivatives clearing organizations supervised by the Commodities Futures Trading Commission is considered equivalent to European standards. In the context of equivalence, one main difference between legal and supervisory arrangements for CCPs in the US is the minimum liquidation period or the margin period of risk in the EU for financial instruments other than for OTC derivatives. US regulations for the minimum liquidation period for US DCOs for financial

instruments other than OTC derivatives is one day; the minimum liquidation period under EMIR is two days. As a result, under the current EU system, ESMA concluded that clients of EU CCPs will be required to post more initial margin than they would as clients of a US DCO giving rise to the risk of regulatory arbitrage.

Under the proposed amendment, European CCP's would have the option to offer both a two day net margin model and a one-day gross margin model. The option of both models provides European CCP's with the ability to compete on a level playing field with recognized US CCPs. It has been clarified that affiliate positions will not benefit from the new one-day gross account. However, affiliate clearing for these purposes no longer includes so-called "indirect clearing" where a different client ultimately sits behind the transaction. ESMA has submitted the amending RTS to the European Commission for endorsement.

The final report is available at: <https://www.esma.europa.eu/press-news/esma-news/emir-esma-proposes-one-day-margin-period-risk-ccp-client-accounts>.

### **European Securities and Markets Authority Proposals to Improve Access by Regulators to Trade Repository Data**

On 5 April, 2016, ESMA published its final report containing final draft amending regulatory technical standards regarding requirements for regulator access to Trade Repositories data and the subsequent aggregation and comparison of that data. The European Market Infrastructure Regulation requires ESMA to develop draft technical standards specifying the frequency and the details of the information to be made available to regulators by TRs. TRs are to provide regulators with access as required. ESMA has amended the RTS, first published in 2013, to provide regulators with better access to data and to improve their ability to compare and aggregate data. For the exchange of data between TRs and regulators, ESMA has proposed an XML template based on ISO 20022 methodology. ISO 20022 is a universal message scheme for the financial services industry. This methodology can be used to facilitate aggregation and comparison of data across repositories. The amended RTS also defines the minimum operational standards to allow direct and immediate access to TR data and the aggregation and comparison of data across TRs. The amended RTS sets out definitive timelines for the provision of data to regulators. ESMA expects that this will enable regulators to better plan and schedule their internal processes for gathering and analysis of TR data. The RTS provides minimum standards for secure machine to machine connection and data exchange between TRs and regulators. In particular, ESMA has proposed enhanced procedures for data security, including the use of electronic signatures and data encryption protocols when providing regulators access to TR data. ESMA's proposed amendments to operation standards on data access also require TRs to validate in a timely manner requests from regulators. ESMA has submitted the additional final draft RTS to the European Commission for endorsement.

The final report is available at: [https://www.esma.europa.eu/sites/default/files/library/2016-422\\_final\\_report\\_rts\\_on\\_tr\\_data\\_under\\_art.81\\_emir.pdf](https://www.esma.europa.eu/sites/default/files/library/2016-422_final_report_rts_on_tr_data_under_art.81_emir.pdf).

## **Financial Crime**

### **US Treasury Deputy Assistant Secretary Discusses Strengthening of US Anti-Money Laundering and Combating the Financing of Terrorism**

On April 6, 2016, at the SIFMA Anti-Money Laundering and Financial Crimes Conference, Jennifer Fowler, Deputy Assistant Secretary of the US Treasury, spoke regarding progress that the US has made in strengthening its framework for anti-money laundering and combatting the financing of terrorism. Fowler noted that the Financial Action Task Force is currently undergoing a mandatory assessment of its AML/CFT framework, focusing not only on technical compliance with the FATF standards, but more importantly, how effectively those standards are implemented. Fowler also addressed ways the US can improve in combating illicit finance, specifically, among other things, by: (i) seeking to clarify and strengthen customer due diligence requirements for financial institutions; and (ii) ensuring that companies know and disclose their ultimate, or beneficial, owners to the government at the time of company formation.

Fowler's speech is available at: <https://www.treasury.gov/press-center/press-releases/Pages/j10409.aspx>.

### **EU Regulation and Template on Public Disclosure of Managers Transactions**

On April 5, 2016, a Commission Delegated Regulation and Commission Implementing Regulation supplementing the Market Abuse Regulation were published in the Official Journal of the European Union. The Delegated Regulation extends the exemption to certain public bodies and central banks of third countries from the obligations set out in MAR, including amongst others, the Reserve Bank of Australia, the Central Bank of Brazil, the Bank of Canada and the People's Bank of China. The Delegated Regulation also supplements the MAR with additional indicators of market manipulation relating to false or misleading signals and to price securing. It details the thresholds for the disclosure by market participants of inside information to regulators and clarifies which of the national regulators an issuer should notify any delay in disclosing inside information to. The Delegated Regulation sets out the conditions under which managers may trade during closed periods in certain exceptional circumstances, such as severe financial difficulty where shares must be sold immediately, and where the characteristics of the trade are such that the beneficial interest in the relevant security does not change (i.e., employee share or saving scheme). A person engaging in trading during closed periods is required to request permission from the issuer and the regulator. Types of notifiable transactions include, amongst others, acquisition, disposal, short sale, subscription and exchange. The Delegated Regulation enters into force on April 24, 2016, and will apply from July 3, 2016.

The Commission Implementing Regulation provides the template for notification and public disclosure of managers' transactions. The template requires information on all managers' transactions conducted on a particular day. The ITS entered into force on April 6, 2016, and will apply from July 3, 2016.

The Delegated Regulation is available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2016.088.01.0001.01.ENG&toc=OJ:L:2016:088:TOC](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.088.01.0001.01.ENG&toc=OJ:L:2016:088:TOC) and the ITS is available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2016.088.01.0019.01.ENG&toc=OJ:L:2016:088:TOC](http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.088.01.0019.01.ENG&toc=OJ:L:2016:088:TOC).

## **Financial Services**

### **US Department of Labor Finalizes Rules to Impose Fiduciary Duty on Financial Advisors Who Provide Retirement Advice to Retail Customers**

On April 6, 2016, the US Department of Labor announced final rules that will, for the first time, subject investment advice to IRA and other non-ERISA plan clients to ERISA's fiduciary standards and remedies. Currently, brokers and dealers and other advisers to retail retirement clients are required to adhere to a "suitability" standard with respect to their investment advice. Under the new rule and related prohibited transaction exemptions, which will be applicable beginning in April 2017, these financial professionals must act in the "best interests" of their client in order to continue receiving common forms of compensation (such as commissions, third party payments and other forms of variable remuneration). In eliminating certain compliance requirements, the final rule is less stringent than the proposed rule issued in April 2015, but it still represents a major departure from the status quo.

The final rule is available at: <https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-07924.pdf> and the fact sheet released by the White House is available at: <https://www.whitehouse.gov/the-press-office/2016/04/06/fact-sheet-middle-class-economics-strengthening-retirement-security>.

### **US Internal Revenue Service and US Treasury Department Issue Anti-Inversion Regulations**

On April 4, 2016, the US Internal Revenue Service issued a proposal under Section 385 of the Internal Revenue Code with respect to the treatment of instruments issued by corporations in related-party transactions as debt or equity for federal tax purposes. On the same day, the US Treasury Department also took action to limit US corporate "inversions" and to restrict earnings stripping aspects of such transactions.

Specifically, the US Treasury regulations would, among other things, limit corporate inversions by disregarding foreign parent stock attributable to certain prior inversions or acquisitions of US companies. Additionally, debt issued by a US subsidiary to its foreign parent would be treated as equity under certain circumstances. The proposals have raised concerns with respect to the impact on US subsidiaries of foreign banking organizations, specifically intermediate holding companies subject to the Federal Reserve Board's total loss absorbing capacity (TLAC) requirements. These new proposals add further complexity regarding the tax treatment of TLAC debt.

The IRS proposed regulations are available at: <https://www.gpo.gov/fdsys/pkg/FR-2016-04-08/pdf/2016-07425.pdf> and the Treasury Department press release is available at: <https://www.treasury.gov/press-center/press-releases/Pages/j10405.aspx>.

## FinTech

### US Comptroller of the Currency Discusses Innovation in the Financial Services Industry

On April 7, 2016, at the American Banker Retail Banking Conference, US Comptroller of the Currency Thomas J. Curry discussed innovation in the financial services industry and its impact on retail bankers, consumers of banking services and regulatory agencies. Comptroller Curry noted that if banks are to remain relevant in a changing world, they have to be able to adapt quickly to changes in technology and business practices. He also noted the importance of regulators being open to such changes but cautioned that regulators do so in a responsible way that does not threaten the safety of the system or the financial well-being of bank customers. The Comptroller also spoke about the OCC's principles for implementing a regulatory framework to support responsible innovation in the federal banking system.

Comptroller Curry's remarks are available at: <http://www.occ.gov/news-issuances/speeches/2016/pub-speech-2016-42.pdf>.

### UK Government Announces Steps to Support UK FinTech Growth

On April 11, 2016, the Economic Secretary to the UK Treasury, Harriett Baldwin, gave a speech at the 2016 Innovate Finance Global Summit in London. The Economic Secretary announced certain policies that the UK Government had adopted to support the FinTech sector, including establishing a FinTech panel, the delivery of a support function to set an overarching UK FinTech strategy and establishing 'FinTech Bridges' to work with priority global markets to assist UK FinTechs to grow internationally.

The HM Treasury press release is available at: <https://www.gov.uk/government/news/uks-world-leading-fintech-industry-to-be-given-new-government-boost>.

## Funds

### European Securities and Markets Authority Discussion on Classes of Undertakings for Collective Investments in Transferable Securities

On April 7, 2016, the ESMA published a discussion paper on the recognition of the different share classes offered by Undertakings for Collective Investments in Transferable Securities funds in different EU jurisdictions. ESMA identified in 2014 diverging national practices as to the types of share class permitted under the UCITS Directive. ESMA is seeking stakeholder's views on its proposed framework for UCITS share classes throughout the European Union, in particular, whether and how share classes work under the ESMA principles. The paper describes the nature of the different share classes and establishes common principles which could form the basis of a regulatory framework for all share classes. Share classes, in the context of UCITS, are different types of units or shares belonging to the same UCITS. Share classes allow for customisation of investment and there is no legal segregation of assets between share classes. The main issue addressed in the report is that while the UCITS Directive covers funds, it stays silent on the definition

and scope of share classes. As a consequence different jurisdictions have different standards and therefore some share classes can be set up in some jurisdictions but not in others.

The discussion paper outlines four principles which ESMA recommends are to be followed when recognizing share classes for UCITS. The first principle, the common investment objective, states that share classes of the same fund should have a common investment objective reflected by a common pool of assets. The second principle, non-contagion, provides that UCITS management companies should implement appropriate procedures to minimize risk features that are specific to one class of share which could potentially have an adverse impact on other share classes in the same fund. The third principle, predetermination, requires that all features of the share class should be predetermined before it is set up. The final principle, transparency, requires that all differences between share classes of the same fund should be disclosed to investors when they have a choice between two or more classes. In addition to the principles outlined, ESMA states that share classes should never be set up to circumvent the rules of the UCITS Directive on diversification, derivative eligibility and liquidity. Responses to the discussion paper are due by June 6, 2016. ESMA will then consider the feedback that it receives on its consultation and will provide a response to the feedback by the end of 2016.

The discussion paper is available at: [https://www.esma.europa.eu/sites/default/files/library/2016-570\\_discussion\\_paper\\_on\\_ucits\\_share\\_classes\\_2016\\_0.pdf](https://www.esma.europa.eu/sites/default/files/library/2016-570_discussion_paper_on_ucits_share_classes_2016_0.pdf).

#### **Financial Conduct Authority Publishes Thematic Review on Investor Expectation Satisfaction**

On April 6, 2016, the Financial Conduct Authority published its thematic review on how firms in the fund management sector meet investors' expectations. The FCA considered whether UK authorized investment funds and segregated mandates were operated in line with investors' expectations as outlined in market material, disclosure material and investment mandates. A sample of 23 funds was reviewed, which were all UCITS schemes sold to retail investors. The FCA found that generally fund management firms had taken the right steps to meet investors' expectations and comply with their responsibilities to investors and that firms generally provided adequate information about funds' strategies, characteristics and inherent risks. This provides customers and financial advisers with better opportunities to make informed investment decisions. The review highlights the need for investors to be provided with accessible information on the risks associated with investing; the FCA found that most firms disclosed the key risks associated with their funds. The FCA will be writing to all the firms involved the review to provide individual feedback. Firms that were deemed not to have effectively managed their risks are required by the FCA to make the associated improvements. The FCA noted that it will follow up on the results of the review through its routine supervision.

The FCA's review is available at: <http://www.fca.org.uk/static/documents/tr16-3.pdf>.

## **MiFID II**

#### **Draft EU Rules on Investor Protection under MiFID II Adopted by the European Commission**

On April 7, 2016, the European Commission adopted a Delegated Directive on aspects of the revised Markets in Financial Instruments Directive covering rules for the safeguarding of client financial instruments and funds, product governance requirements and inducements.

The rules for the safeguarding of client financial instruments and funds, include, amongst others: (i) a requirement to appoint one individual with overall responsibility for safeguarding client instruments and funds; (ii) a requirement to consider and demonstrate the appropriateness of concluding title transfer collateral arrangements with non-retail clients; (iii) due diligence requirements when financial instruments held on behalf of a client are deposited with a third party; (iv) rules on using more than one third party when depositing client instruments; (v) restrictions on the funds deposited with group entities to 20 percent of all funds; and (vi) requirements on the use of client financial instruments, including obtaining the client's prior express consent.

The product governance rules apply to firms that create, develop and issue products (i.e., manufacturers) and to firms that distribute products (i.e., distributors). The rules will apply to all products sold on the primary and secondary markets. A proportionate approach is to be adopted, depending on the complexity of the product, including the nature of the instrument, service and the target market. For complex products, including instruments subject to bail-in, the target market will need to be identified in more detail than required for simpler products.

Under MiFID II, the ability of firms to receive or pay inducements is to be more restricted more than under the existing MiFID regime. The adopted Delegated Directive details further the conditions that must be met for a firm to receive or pay an inducement. It requires firms to hold evidence that any fees, commissions or non-monetary benefits paid or received by the firm are designed to enhance the quality of the relevant service to the client. Finally, it imposes disclosure requirements on firms that do receive or pay inducements.

The adopted Delegated Directive is subject to approval by the European Parliament and the Council of the European Union before it can enter into force. As a directive, EU Member States will need to transpose the rules in the adopted Delegated Directive into national laws. It is proposed that Member States should apply those laws from the date of application of MiFID II, which is currently January 3, 2017. However, a legislative proposal published earlier this year proposes to postpone the application date until January 2018.

The Delegated Directive is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF>.

### **European Securities and Markets Authority Reviews Approach to Supervision of Suitability Requirements under MiFID**

On April 7, 2016, the ESMA published a peer review report on compliance with the suitability requirements under the existing Markets in Financial Instruments Directive. The review assessed during the period January 1, 2013, to December 31, 2014 how national regulators approach supervision of firms to ensure compliance with the MiFID suitability requirements when investment advice is given to retail clients. The MiFID suitability requirements aim to ensure that firms only recommend suitable investment products to investors taking into account the client's profile. ESMA found, amongst other things, that only some regulators provide information on the tools they use to monitor compliance with the suitability requirements, many regulators do not undertake targeted supervision projects relating to suitability and enforcement action is rare as most regulators consider that their supervisory approach is sufficient to address any issues. ESMA will analyze the findings and determine areas where further convergence between the approaches taken by national regulators is needed.

The report is available at: <https://www.esma.europa.eu/press-news/esma-news/esma-finds-room-improvement-in-national-supervision-investment-advice-retail>.

## **Recovery & Resolution**

### **US Federal Reserve Board and Federal Deposit Insurance Corporation Jointly Determine that Five US Global Systemically Important Banking Organization Resolution Plans are Not Credible**

On April 13, 2016, the US Federal Reserve Board and Federal Deposit Insurance Corporation jointly determined that the 2015 resolution plans of the following five US domestic global systemically important banking organizations are not credible: Bank of America, Bank of New York Mellon, JP Morgan Chase, State Street and Wells Fargo. The agencies also jointly identified weaknesses in the resolution plans of Goldman Sachs and Morgan Stanley, but did not make joint determinations as to the plans and their deficiencies. Neither agency found that Citigroup's resolution plan was not credible, although the agencies did identify certain shortcomings that Citigroup must address.

Under Section 165(d) of the Dodd-Frank Act, bank holding companies with total consolidated assets of \$50 billion or more and nonbank financial companies designated by the FSOC for supervision by the Federal Reserve Board must

periodically submit resolution plans to the Federal Reserve Board and the FDIC. The five firms receiving a joint notice of deficiencies must remediate those deficiencies by October 1, 2016, to avoid imposition of more stringent prudential requirements on the firm until it remediates the deficiencies. Such prudential requirements could include more stringent capital, leverage or liquidity requirements, as well as restrictions on growth, activities or operations of the firm, or its subsidiaries.

The agencies are continuing to assess the plans for the four foreign banking organizations that filed resolution plans on July 1, 2015, including Barclays PLC, Credit Suisse Group, Deutsche Bank AG and UBS.

The Federal Reserve Board is releasing the feedback letters issued to each firm. The agencies are also issuing “Resolution Plan Assessment Framework and Firm Determinations (2016),” which provides further information on the determinations and the agencies’ processes for reviewing the plans. Additionally, the agencies are releasing new guidance for the July 2017 submissions for all covered companies. The deadline for the next full plan submission for the eight US GSIBs is July 1, 2017.

The Federal Reserve Board press release, which includes each of the firm feedback letters, 2016 assessment framework and 2017 resolution plan guidance, is available at:

<http://www.federalreserve.gov/newsevents/press/bcreg/20160413a.htm>.

### **UK Payment Systems Regulator Will Not Introduce New Access and Governance Requirements for Card Payment Schemes**

On April 7, 2016, the UK Payment Systems Regulator announced that after consideration, it had decided that it would not be imposing any new access or governance requirements on card payment schemes. The PSR introduced governance requirements for interbank payment systems in 2015. The PSR has considered the information it has gathered as well as the improvements made in the area through EU legislation, in particular, the Payment Services Regulations 2009. The PSR will continue to assess whether any changes are necessary.

The PSR announcement is available at: <https://www.psr.org.uk/psr-publications/news-announcements/statement-on-indirect-access-and-governance-requirements>.

## **People**

### **Deputy Governor of the Bank of England and Chief Executive of the Prudential Regulation Authority Appointed**

On April 8, 2016, Sam Woods was appointed Deputy Governor of the Bank of England and Chief Executive of the Prudential Regulation Authority. Mr. Woods will succeed Andrew Bailey on July 1, 2016. Mr. Bailey will move to the FCA as Chief Executive when Mr. Woods takes on the role of Deputy Governor. Mr. Woods, who previously worked for HM Treasury and in the private sector for Diageo and McKinsey & Company, will take up a renewable term of five years as Deputy Governor.

The press release is available at: <https://www.gov.uk/government/news/prudential-regulation-authority-chief-executive-officer-announced>.

## **Upcoming Events**

April 14, 2016: US Senate Committee on Banking, Housing and Urban Affairs hearing entitled “Examining Current Trends and Changes in the Fixed-Income Markets.”

April 14, 2016: US House Financial Services Committee hearing entitled: “The JOBS Act at Four: Examining Its Impact and Proposals to Further Enhance Capital Formation.”

April 14, 2016: FDIC's Systemic Resolution Advisory Committee open meeting regarding issues and developments related to the resolution of systemically important financial companies pursuant to the Dodd-Frank Act.

April 15, 2016: EBA, public hearing on its draft report, Leverage Ratio (registration closed).

April 29, 2016: First Single Resolution Board Conference: Charting the Course—Making Bank Resolution Work.

May 17, 2016: European Commission, public hearing on the EU regulatory framework for financial services, understanding the interactions and cumulative impact of legislation.

### Upcoming Consultation Deadlines

April 15, 2016: European Central Bank Consultation on Institutional Protection Schemes.

April 21, 2016: PSR Report into Banks and UK Payment Infrastructure.

May 2, 2016: FDIC/SEC Notice of Proposed Rulemaking on Covered Broker-Dealer Provisions under Title II of the Dodd-Frank Act.

May 3, 2016: FCA Consultation on Proposed Changes to Payment Accounts Regulation.

May 13, 2016: Federal Reserve Board Notice of Proposed Rulemaking on Risk-Based Capital Guidelines: Implementation of Capital Requirements for Global Systemically Important Bank Holding Companies.

May 16, 2016: PRA Consultation on Proposed Amendments to Rules on Contractual Recognition of Bail-in.

May 20, 2016: ESMA Consultation on Guidelines for Information on Commodity and Spot Markets under the Market Abuse Regulation.

May 26, 2016: FDIC Notice of Proposed Rulemaking on Recordkeeping for Timely Deposit Insurance Determination.

June 3, 2016: Federal Reserve Board Notice of Proposed Rulemaking on Single-Counterparty Credit Limits for Domestic and Foreign Bank Holding Companies.

June 3, 2016: Federal Reserve Board Notice for Proposed Agency Information Collection Activities regarding New Data Items for Regulatory Reporting by Foreign Banking Organizations.

June 14, 2016: European Commission Consultation on Harmonizing EU Insolvency Regimes Under its Capital Markets Union Action Plan.

June 22, 2016: EBA Consultation on Changes to Calculation of Interest Rate Risk on Capital Requirements.

June 29, 2016: PRA Consultation on Underwriting Standards for Buy-to-Let Mortgage Contracts.

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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