



Financial Regulatory Developments Focus

In this week's newsletter, we provide a snapshot of the principal United States, 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 Senate Banking Committee Holds Bank Secrecy Act Modernization Hearing

On January 9, 2018, the US Senate Committee on Banking, Housing and Urban Affairs held a full committee hearing entitled “Combating Money Laundering and Other Forms of Illicit Finance: Opportunities to Reform and Strengthen BSA Enforcement.” Chairman Mike Crapo and ranking member Sherrod Brown each delivered opening statements at the hearing. Mr. Crapo highlighted the vital importance of robust anti-money laundering laws, rules and regulations, and their implementation through financial institution policies and procedures. Mr. Crapo also noted, however, that much has changed since the Bank Secrecy Act was enacted nearly 50 years ago, and stressed the need for its modernization. Mr. Brown also emphasized the importance of a robust AML regime, and noted that many large US and international financial institutions have been penalized for AML deficiencies. Mr. Brown noted that broadening information-sharing may make sense but that important questions about privacy protections must also be addressed. The witnesses for the hearing were Mr. Greg Baer, President, The Clearing House Association; Mr. Dennis Lormel, President and CEO, DML Associates (and former Chief, FBI Financial Crimes Program); and Ms. Heather Lowe, Legal Counsel and Director of Government Affairs, Global Financial Integrity. The Senate Banking Committee will hold a second hearing on the topic on January 17, 2018, entitled “Combating Money Laundering and Other Forms of Illicit Finance: Administration Perspectives on Reforming and Strengthening BSA Enforcement.” The witnesses will be Sigal Mandelker, Under Secretary of the Treasury for Terrorism and Financial Crimes, and M. Kendall Day, Acting Deputy Assistant Attorney General, Criminal Division, U.S. Department of Justice.

The text of Mr. Crapo’s opening statement is available at:

<https://www.banking.senate.gov/public/index.cfm/republican-press-releases?ID=7E42C025-F28A-484A-8E9E-ADF5D1C4810E>.

The text of Mr. Brown’s opening statement is available at:

<https://www.banking.senate.gov/public/index.cfm/democratic-press-releases?ID=D6920C37-280D-4104-A7EF-4DED14C31171>.

The prepared testimony of Mr. Baer, Mr. Lormel and Ms. Lowe and the archived website is available at:

<https://www.banking.senate.gov/public/index.cfm/2018/1/combating-money-laundering-and-other-forms-of-illicit-finance-opportunities-to-reform-and-strengthen-bsa-enforcement>.

UK Prudential Regulation Authority Publishes Expectations on Disclosures of Expected Credit Loss Under IFRS 9

On January 8, 2018, the U.K. Prudential Regulation Authority published a “Dear CFO” letter that was sent to the Chief Finance Officers of larger U.K.-headquartered credit institutions. The “Dear CFO” letter sets out the PRA’s expectations as to the minimum disclosures those firms should be making on transition to the new standard for loan loss provisioning based on “expected credit losses” that forms part of standard 9 of International Financial Reporting Standards. The ECL requirements will replace the old “incurred loss” provisioning model that was contained in standard 39 of the International Accounting Standards. ECL will require banks to provision for expected credit losses from the time a loan is originated, rather than awaiting “trigger events” signaling imminent losses. IFRS 9 has been implemented through Commission Regulation (EU) 2016/2067, which requires credit institutions and investment firms that use IFRS to prepare their financial statements to apply IFRS 9 as of the starting date of their first financial year starting on or after January 1, 2018. The Regulation permits banks and investment firms that are required to use IFRS 9 to apply transitional provisions where the application of IFRS 9 leads to a significant increase in credit loss provisions and a decrease in the firm’s Common Equity Tier 1 capital. Firms that use these transitional arrangements must publicly disclose their own funds, capital ratios and leverage ratios with and without the application of those arrangements.

The “Dear CFO” letter sets out general comments on the scope and objective of the ECL transition disclosures and specifies the minimum content that those disclosures should contain. It also provides some guidance as to how firms should go about making disclosures related to quantitative measurement uncertainty and sensitivity. The letter notes that a dedicated taskforce on disclosures about ECL will also be developing a form of quantitative sensitivity disclosure that is most useful for market participants.

The Dear CFO letter is available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2017/letter-to-firms-on-ifs9-transition-disclosures-january-2018.pdf>.

Consumer Protection

UK Financial Conduct Authority Highlights Firms’ Failings in Providing and Distributing Contracts for Difference

On January 10, 2018, the Financial Conduct Authority published a “Dear CEO” letter that was sent to firms that offer contracts for difference products to retail customers on either an advisory or discretionary portfolio management basis (including pursuant to limited power of attorney).

The “Dear CEO” letter follows a review conducted by the FCA which assessed internal processes, policies, controls and oversight arrangements at a sample of 19 providers and 15 distributors of CFD products to retail customers. The “Dear CEO” letter identifies a number of areas of concern: target market identification and alignment of the target market to the characteristics of the product; communication, oversight and challenge; the process for taking on new distributors; management of conflicts of interest; the use of management information and key performance indicators; client categorization; and remuneration arrangements.

The FCA considers that there is a high risk that firms across the sector are not meeting its rules and expectations when providing and distributing CFDs and that consumers are likely to experience poor outcomes unless these poor practices are addressed. The letter highlights the need for firms overall to improve a number of oversight and control arrangements to reach the standard required by FCA rules and guidance. The FCA will conduct further work on CFDs and firms may be asked to take part in a follow-up review to assess how they have responded to the feedback in the Dear CEO letter. The FCA will also be assessing firms’ compliance with the new Product Intervention and Product Governance sourcebook, which came into effect on January 3, 2018, implementing as rules the product governance requirements of the revised Markets in Financial Instruments Directive.

The ‘Dear CEO’ letter is available at: <https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-cfd-review-findings.pdf>.

Derivatives

Proposed EU Guidelines on CCP Requirement for Anti-Procyclicality Margin Measures

On January 8, 2018, the European Securities and Markets Authority launched a consultation on proposed guidelines for national regulators of CCPs on the application of the rules requiring CCPs to adopt anti-procyclicality margin measures.

The European Market Infrastructure Regulation requires CCPs to impose, call and collect margins to limit its credit exposures from clearing members. A CCP must also regularly monitor and, if necessary, revise the level of its margins to reflect current market conditions taking into account any potentially procyclical effects of those revisions. The Regulatory Technical Standards on requirements for CCPs provides that CCPs must use at least one of three options to limit procyclicality to the extent that the financial soundness of the CCP is not negatively affected.

During the EMIR Review, ESMA highlighted that the implementation of these requirements differs across CCPs and that the effectiveness and supervision of these measures could be improved. The draft guidelines seek to clarify and ensure consistent application of the requirements across the EU.

The consultation closes on February 28, 2018. ESMA intends to publish final guidelines, which will be addressed to national regulators, by the end of the first half of 2018.

The consultation paper is available at: <https://www.esma.europa.eu/press-news/esma-news/esma-consults-ccp-anti-procyclicality-margin-measures>.

Enforcement

Federal Reserve Board Adjusts Maximum Civil Money Penalties

On January 10, 2018, the US Board of Governors of the Federal Reserve System announced a final rule adjusting the maximum amount of its civil money penalties. This adjustment is made to account for inflation, and is required by the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015. The announcement contains a table reflecting each adjusted civil money penalty, organized by statute. The adjusted civil money penalties took effect on January 10, 2018.

The text of the final rule is available at:

<https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180112a1.pdf>.

Financial Market Infrastructure

European Securities and Markets Authority Has Concerns on Fees Charged by Credit Rating Agencies and Trade Repositories

On January 11, 2018, ESMA published a Thematic Report, following its supervisory review of the current fee structures in the credit rating and trade repository industries. The CRA Regulation requires CRAs to ensure that fees for the credit rating and ancillary services are not discriminatory and are based on actual costs. Similarly, EMIR requires TRs to provide non-discriminatory access and charge publicly disclosed and cost-related fees.

ESMA has compiled its Thematic Report using information from publicly available resources, periodical submissions to ESMA and dedicated requests for information from supervised entities. It has also used information gained from users of CRA and TR services. The Thematic Report identifies three areas in which CRAs and TRs need to improve their fee practices and to which ESMA proposes to give supervisory priority. These are: transparency and disclosure, the fee-setting process and interaction with entities related to CRAs and TRs.

The Thematic Report is accompanied by factsheets summarizing ESMA's findings on TRs' and CRAs' fees.

The Thematic Report is available at: https://www.esma.europa.eu/sites/default/files/library/esma80-196-954_thematic_report_on_fees_charged_by_cras_and_trs.pdf, the Factsheet on Trade Repositories' Fees is available at: https://www.esma.europa.eu/sites/default/files/library/esma71-99-923_factsheet_tr_fees.pdf and the Factsheet on CRAs' Fees is available at: https://www.esma.europa.eu/sites/default/files/library/esma71-99-928_factsheet_cra_fees.pdf.

MiFID II

European Securities and Markets Authority Announces Delay to Publication of Double Volume Cap Data

On January 9, 2018, ESMA announced that it will delay the publication of data for January 2018 on the double volume cap mechanism introduced by the Markets in Financial Instruments Regulation from January 3, 2018. The DVC

mechanism introduced by MiFIR seeks to ensure that dark pool trading using waivers from pre-trade transparency requirements does not unduly harm price formation. It does so by capping the amount of trading for orders placed in systems which are based on a trading methodology using the reference price waiver and certain transactions using the negotiated price waiver.

ESMA expects to work with national regulators and trading venues to address issues it has identified with the quality and completeness of the data it has so far received from trading venues. It hopes to publish the data in March 2018.

The press release is available at: https://www.esma.europa.eu/sites/default/files/library/esma71-99-925_esma_dvc_delay.pdf.

People

Federal Reserve Board Announces 2018 Chair Appointments for Federal Reserve Banks

On January 10, 2018, the Federal Reserve Board announced its 2018 chair and deputy chair appointments for Federal Reserve Banks. Each year, the Federal Reserve Board appoints one member from each Federal Reserve Bank's nine-member board of directors to serve as chair, and one member to serve as deputy chair.

The Federal Reserve Board press release announcing the appointments is available at:

<https://www.federalreserve.gov/newsevents/pressreleases/other20180110b.htm>.

Upcoming Events

January 22, 2018: EBA public hearing on draft RTS on the methods of prudential consolidation under the CRR

January 23, 2018: public hearing on EBA consultation on Amended Technical Standards for Benchmarking of Internal Models under the Capital Requirements Directive

February 5, 2018: Public hearing on EBA discussion paper on EU implementation of the revised market risk and counterparty credit risk frameworks

February 19, 2018: PRA and FCA New Bank Start-up Unit Seminar

February 19, 2018: Joint EBA and ESMA public hearing on consultations on draft RTS and ITS under the STS Regulation

March 22, 2018: U.K. Government's second annual International Fintech Conference

Upcoming Consultation Deadlines

January 19, 2018: FCA consultation on removing non-Handbook guidance superseded by MiFID II

January 25, 2018: ESMA consultation on amendments to Systematic Internalisers' quote rules under RTS 1 of MiFID II

January 26, 2018: U.K. Banking Standards Board consultation considering what good banking outcomes look like for consumers

January 29, 2018: European Commission legislative proposals for enhanced powers for ESAs and the European Systemic Risk Board

January 29, 2018: European Commission proposed Regulation moving the EBA to Paris due to Brexit

January 31, 2018: EBA consultation on Pillar 2 draft Guidelines

January 31, 2018: EBA consultation on Amended Technical Standards for Benchmarking of Internal Models under the Capital Requirements Directive

February 2, 2018: Bank of England consultation: Procedure for the Enforcement Decision Making Committee

February 2, 2018: FSB consultations on proposed guidance on principles of bail-in execution and on the funding strategy elements of an implementable resolution plan

February 5, 2018: Basel Committee consultation on a proposed technical amendment to the Net Stable Funding Ratio

February 9, 2018: EBA consultation on draft RTS on the methods of prudential consolidation under the CRR

February 15, 2018: Comments due on the Federal Reserve's proposed guidance on supervisory expectations for boards of directors and its proposed new rating system for large financial institutions

February 21, 2018: FCA consultation - transitioning FCA solo-regulated firms and individuals to SM&CR (CP 17/40)

February 21, 2018: FCA consultation - transitioning insurers and individuals to SM&CR (CP 17/41)

February 21, 2018: FCA consultation - the duty of responsibility for insurers and FCA solo-regulated firms under the SM&CR (CP 17/42)

February 21, 2018: PRA consultation - extending the SM&CR to insurers (CP 28/17)

February 23, 2018: European Commission proposals to revise the prudential regime for investment firms

February 26, 2018: European Commission consultation on SME listing

February 27, 2018: PRA consultation on authorization and supervision of international banks (CP29/17)

February 27, 2018: PRA consultation on authorization and supervision of international insurers (CP30/17)

February 28, 2018: European Commission consultation on supervisory reporting requirements

February 28, 2018: ESMA consultation on draft guidelines on the requirement for CCPs to adopt anti-procyclicality margin measures

March 5, 2018: Comments to Federal Reserve Board's Proposed Regulation M Revisions due

March 5, 2018: Comments to Federal Reserve Board's Proposed Call Report Revisions due

March 6, 2018: PRA consultation on proposed updates to the Pillar 2 reporting requirements

March 6, 2018: PRA consultation on model risk management principles for stress testing

March 9, 2018: Basel Committee discussion paper on the regulatory treatment of sovereign exposures

March 9, 2018: ESMA consultation on draft RTS under the new Prospectus Regulation (ESMA31-62-802)

March 15, 2018: Comments to Federal Reserve Board's proposed guidance clarifying risk management supervisory expectations for large financial institutions due

March 15, 2018: EBA Discussion Paper on EU implementation of the revised market risk and counterparty credit risk frameworks

March 15, 2018: EBA consultation on draft RTS for risk retention under STS Regulation

March 15, 2018: EBA consultation on draft RTS on homogeneity of underlying exposures in STS securitizations under the STS Regulation

March 19, 2018: ESMA consultation on draft technical standards on the content and format of the “Simple, Transparent and Standardized” notification under the STS Regulation

March 19, 2018: ESMA consultation on draft technical standards on disclosure requirements, operational standards, and access conditions under the STS Regulation

March 19, 2018: ESMA consultation on draft technical standards on third-party firms providing STS verification services under the STS Regulation

March 23, 2018: Basel Committee consultation on revised principles for supervisory and bank stress testing

April 9, 2018: PRA consultation on MREL reporting requirements

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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