

FINANCIAL REGULATORY DEVELOPMENTS FOCUS

In this week's newsletter, we provide a snapshot of the principal U.S., 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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AML/CTF, Sanctions and Insider Trading

FinCEN Provides Temporary Exception Under the Beneficial Ownership Rule for CDs and Loan Accounts that Automatically Rollover or Renew

On May 16, 2018, the U.S. Financial Crimes Enforcement Network announced that it was granting a 90-day exception from compliance with the beneficial ownership requirements under its Customer Due Diligence Requirements for Financial Institutions rule. The exception is limited to certain financial products and services (i.e., certificates of deposit and loan accounts) that automatically rollover or renew and were established prior to the Beneficial Ownership Rule's compliance date of May 11, 2018. The Beneficial Ownership Rule requires covered financial institutions to identify and verify the identity of each natural person who directly or indirectly owns 25% or more of the equity interests of a legal entity customer, as well as one natural person with "significant responsibility to control, manage or direct" the legal entity customer. These requirements apply each time a new formal banking relationship with a legal entity customer is created, which includes each time a certificate of deposit is rolled over or a loan is rolled over or renewed. In granting this exceptive relief, FinCEN noted that some covered financial institutions have expressed concerns with their ability to comply with the Beneficial Ownership Rule with respect to these products, because the institutions have not been treating these rollovers or renewals as new accounts and have established processes to automatically rollover or renew these products. FinCEN will use the 90 days for which the exception is applicable to determine whether further exceptive relief is appropriate for these types of products that were established prior to the May 11, 2018 compliance date. The 90-day exceptive period is set to expire on August 9, 2018.

The full text of the FinCEN ruling is available at:

https://www.fincen.gov/sites/default/files/administrative_ruling/2018-05-16/FinCEN%20Ruling%20CD%20and%20Loan%20Rollover%20Relief_FINAL%20508.pdf.

UK Joint Money Laundering Steering Group Publishes Revised AML/CTF Guidance for Asset Finance and Syndicated Lending

On May 17, 2018, the U.K. Joint Money Laundering Steering Group finalized minor changes to Part II of its anti-money laundering and counter-terrorist financing guidance in relation to two sectors, namely asset finance and syndicated lending.

The JMLSG consulted on the proposed changes in a consultation that closed on March 30, 2018. The revisions do not make substantive changes to the existing guidance. Instead, the revised guidance provides clarification on the workings of these two sectors, how to identify customers and how risks should be assessed.

The JMLSG announcement is available at: <http://www.jmlsg.org.uk/news/further-amendments-to-jmlsg-guidance2> and details of the JMLSG consultation is available at: <http://www.jmlsg.org.uk/news/the-joint-money-laundering-steering-group-jmlsg-today-publishes-proposed-re>.

EU Fifth Money Laundering Directive Adopted

On May 14, 2018, the Council of the European Union adopted the EU's Fifth Money Laundering Directive, following the agreement reached between the European Parliament and the Council in December 2017. 5MLD will amend the existing EU Money Laundering Directive. The key changes are:

- I. Extending the scope of "obliged entities" to include providers of exchange services between virtual and fiat currencies as well as custodian wallet providers. These entities will need to register in their home Member State.
- II. Harmonizing the application of enhanced customer due diligence for third countries that are determined by the European Commission to be high risk countries. Member States will be able to apply additional measures, where appropriate.

- III. Reducing the thresholds under which obliged entities are exempt from applying certain CDD measures to prepaid cards. The customer in a remote payment transaction exceeding EUR 50 will need to be identified. In addition, the use of anonymous prepaid cards issued outside the EU will only be permitted where the cards comply with requirements equivalent to EU laws.
- IV. Enhancing the powers of and cooperation between Financial Intelligence Units, including giving them access to information and the ability to exchange it without impediments. This will include access to information on all types of virtual currencies, not only those that are serviced by providers of exchange services and custodian wallet providers.
- V. Requiring Member States to maintain lists of specific functions that qualify as prominent public functions to assist in the identification of politically exposed persons.
- VI. Enhancing access to information on beneficial ownership across the EU and improving transparency in the ownership of companies and trusts.

5MLD will enter into force 20 days after it has been published in the Official Journal of the European Union. Member States must transpose it into their national laws within 18 months of the date it enters into force.

The announcement is available at: <http://www.consilium.europa.eu/en/press/press-releases/2018/05/14/money-laundering-and-terrorist-financing-new-rules-adopted/pdf> and the agreed text of 5MLD is available at: <http://data.consilium.europa.eu/doc/document/PE-72-2017-INIT/en/pdf>.

Bank Prudential Regulation & Regulatory Capital

EU Secondary Legislation Published on the Exclusion of Transactions With Non-EU Non-Financial Counterparties From Credit Valuation Adjustment Risk Charges

On May 18, 2018, a Commission Delegated Regulation was published in the Official Journal of the European Union, setting out Regulatory Technical Standards on procedures for excluding from the own funds requirement for credit valuation adjustment risk transactions with non-financial counterparties that are established in a third country and that do not hold positions over the clearing threshold under the European Market Infrastructure Regulation (so called NFC-s). The RTS supplement the requirements of the Capital Requirements Regulation.

Under the CRR, transactions between an institution and a NFC- are excluded from the own funds requirements for CVA risk, irrespective of whether that NFC- is established in the EU or in a third country. As NFC-s established in third countries are not subject directly to EU regulation, the RTS clarify that EU firms are responsible for: (i) taking the necessary steps to identify all NFC-s under this exemption and calculating accordingly their own funds requirements for CVA risk; (ii) ensuring that exempt counterparties established outside the EU would qualify as NFC-s if they were established in the EU; and (iii) ensuring that counterparties calculate the clearing threshold according to the relevant provisions in EMIR and do not exceed those thresholds.

The final draft RTS were submitted to the Commission in February 2017 and the Commission adopted this Delegated Regulation in January 2018. The Commission Delegated Regulation will take effect on June 7, 2018.

The Commission Delegated Regulation (EU) 2018/728 is available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0728&from=EN>.

EU Implementing Regulation Published for Revised Benchmarking Portfolios, Reporting Templates and Reporting Instructions Under the Capital Requirements Directive

On May 18, 2018, a Commission Implementing Regulation was published in the Official Journal of the European Union, setting out changes to Implementing Technical Standards contained in a Commission

Implementing Regulation published in 2016. The ITS cover benchmarking portfolios, reporting templates and reporting instructions for the purposes of the supervisory benchmarking exercise under the Capital Requirements Directive. The benchmarking exercise is conducted at least annually to assess the internal approaches used by firms for calculating own funds. The European Banking Authority consulted on the proposed revisions to the ITS in a consultation which closed in January 2018 and subsequently submitted draft revised ITS to the European Commission, on which provisions of the Amending Regulation are based.

The Amending Regulation was adopted by the European Commission on March 23, 2018 and will take effect on June 7, 2018. The Amending Regulation contains a derogation from the requirement for institutions to submit information for market and credit risk to national regulators by April 11. In 2018, institutions will be permitted to submit the information by June 30 rather than April 11.

The Amending Regulation (EU) 2018/688 is available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1526657087022&uri=CELEX:32018R0688> and details of the EBA consultation are available at: <https://finreg.shearman.com/european-banking-authority-consults-on-amended-te>.

International Bodies Publish Identification Criteria and Capital Treatment for Simple, Transparent and Comparable Short-Term Securitizations

On May 14, 2018, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions published an updated version of the sound practices document, “Criteria for identifying simple, transparent and comparable short-term securitisations,” which was originally published in 2015. The Basel Committee has also published an updated version of its standards document, “Capital treatment for simple, transparent and comparable short-term securitisations.”

The Basel Committee and IOSCO consulted on the proposed updated Criteria in July 2017. The Basel Committee consulted at the same time on proposed additional guidance and requirements for the purpose of applying preferential regulatory capital treatment for banks acting as investors in, or as sponsors of, STC short-term securitizations, typically in asset-backed commercial paper structures.

The updated Criteria take account of the characteristics of ABCP conduits, such as: (i) the short maturity of the commercial paper issued; (ii) the different forms of program structures; and (iii) the existence of multiple forms of liquidity and credit support facilities. The Basel Committee’s updated standards document outlines how the updated Criteria could be incorporated into the regulatory capital framework for banks.

The revised sound practices document, “Criteria for identifying simple, transparent and comparable short-term securitisations” is available at: <https://www.bis.org/bcbs/publ/d441.pdf> and the updated standards document, “Capital treatment for simple, transparent and comparable short-term securitisations” is available at: <https://www.bis.org/bcbs/publ/d442.htm>.

Funds

Implementing Technical Standards Published for Reporting by Money Market Fund Managers

On May 15, 2018, a Commission Implementing Regulation was published in the Official Journal of the European Union, setting out ITS for a standard reporting template to be used by money market fund managers when complying with their reporting requirements under the Money Market Funds Regulation. The Commission Implementing Regulation is based on the final draft ITS submitted by the European Securities and Markets Authority to the European Commission in November 2017.

The MMFR requires MMF managers to report quarterly to the relevant national regulator, supplying information including on the characteristics, portfolio indicators, assets and liabilities of the MMF. This information is required to enable those national regulators to detect, monitor and respond to risks in the MMF market. The information is also forwarded to ESMA, which maintains a central database of MMFs.

The ITS will enter into force on June 4, 2018 and apply directly across the EU from July 21, 2018.

The Commission Implementing Regulation (EU) 2018/708 is available at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0708&from=EN> and ESMA's final report is available at: <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-final-report-money-market-funds-rules>.

Recovery & Resolution

US Federal Reserve Board Vice Chairman for Supervision Randal Quarles Discusses Cross-Border Resolution

On May 16, 2018, U.S. Board of Governors of the Federal Reserve System Vice Chairman for Supervision Randal Quarles discussed the importance of finding the correct balance in cross-border resolution. He noted that while both single-point-of-entry and bail-in concepts hold promise for overcoming the challenges associated with cross-border resolution, effective cross-border resolution will require cooperation from numerous stakeholders, including home- and host-country regulators, which will require finding the proper balance between flexibility and certainty. Vice Chairman Quarles remarked that home-country regulators prefer the flexibility to allow for capital to easily move within a financial institution, while host-country regulators prefer to have the certainty that adequate capital will be available to repay local customers and creditors in times of stress. Quarles explained that the concepts of flexibility and certainty also apply to other stakeholders in the resolution process, and that these stakeholders can also have a destabilizing effect on an institution during times of stress. He noted that the United States and United Kingdom have traditionally held a unique perspective with respect to cross-border resolution, as both the home- and host-country regulator for a number of financial institutions, noting that the European Union will also likely soon be in a similar position, which provides regulators with strong incentives to view benefits and risks from both perspectives. In discussing the U.S. approach to both capital and liquidity regulations and to resolution, Vice Chairman Quarles noted that from a competitive equity standpoint, U.S. regulations are focused on placing U.S. subsidiaries of non-U.S. financial institutions on equal footing with their U.S. domestic counterparts. He did, however, suggest the possibility that regulations in the U.S. (and globally) can be further tailored and adjusted to streamline and improve the likelihood of successful resolution of both non-U.S. financial institutions operating in the United States and U.S. financial institutions operating abroad. Quarles closed by noting that the Federal Reserve Board would continue to advocate for increased standardization and implementation of regulatory capital rules, increased global transparency and the removal of impediments to a successful single-point-of-entry resolution.

The full text of Vice Chairman Quarles's remarks is available at: <https://www.federalreserve.gov/newsevents/speech/quarles20180516a.htm>.

Upcoming Events

May 23, 2018: U.S. Senate Committee on Banking, Housing, and Urban Affairs hearing: "Ten Years of Conservatorship: The Status of the Housing Finance System"

May 23, 2018: U.S. House Financial Services Committee hearing: "Legislative Proposals to Help Fuel Capital and Growth on Main Street"

May 24, 2018: U.S. Senate Committee on Banking, Housing, and Urban Affairs hearing: “Cybersecurity: Risks to the Financial Services Industry and Its Preparedness”

May 31, 2018: Bank of England and Centre for Economic Policy Research conference on competition and regulation in financial markets

May 31, 2018: public hearing on ESAs’ consultations on amendments to EMIR RTS in the context of the Securitization Regulation

June 12, 2018: FCA Asset Management Conference

June 27, 2018: EBA public hearing on draft Guidelines on disclosure of non-performing and forborne exposures (registration closes June 5, 2018)

Upcoming Consultation Deadlines

May 24, 2018: FSB second consultation on UPI governance

May 24, 2018: CMA working paper on gains from engagement

May 25, 2018: ESMA consultation on supplementary guidance on the CRA endorsement regime

May 25, 2018: Basel Committee consultation on revisions to Pillar 3 Framework

May 27, 2018: EBA consultation on extending the Joint Committee Guidelines on complaints-handling for the securities and banking sectors

May 28, 2018: ECB consultation on proposed guide to internal models

June 4, 2018: European Commission proposed EU covered bonds legislative package

June 5, 2018: HM Treasury consultation on cash and digital payments in the new economy

June 5, 2018: ECB consultation on cyber resilience oversight expectations for Eurozone Financial Market Infrastructures

June 8, 2018: PSR consultation on its review of PSR Directions made in 2015

June 8, 2018: EBA consultation on draft EBA Guidelines on Management of Non-Performing and Forborne Exposures

June 12, 2018: European Commission proposed amending Regulation on cross-border payments in the EU

June 15, 2018: ESAs’ consultation on revised RTS relating to the EMIR clearing obligation for certain classes of OTC derivatives

June 15, 2018: ESAs’ consultation on revised RTS on risk-mitigation techniques for OTC derivative contracts not cleared by a CCP

June 20, 2018: FCA consultation on Model Driven Machine Executable Regulatory Reporting

June 20, 2018: Basel Committee consultation on revisions to minimum capital requirements for market risk

June 21, 2018: FCA consultation on its approach to supervision

June 21, 2018: FCA consultation on its approach to enforcement

June 25, 2018: U.S. Federal Reserve Board and OCC proposed amendments to supplementary leverage ratio calculations for G-SIBs and their insured depository institution subsidiaries

June 28, 2018: FCA consultation on revising the Financial Crime Guide to include insider dealing and market manipulation

July 5, 2018: FCA consultation on improving disclosure by AFMs to their investors (part of the Asset Management Market Study)

July 6, 2018: FSB consultation on proposed Recommendations for consistent national reporting of data on the use of compensation tools to address misconduct risk

July 9, 2018: FCA consultation on its approach to ex post impact evaluation

July 13, 2018: U.S. Federal Reserve Board, FDIC and OCC proposed amendments to regulatory capital rules to address changes to U.S. GAAP

July 17, 2018: EBA consultation on draft Guidelines on the exposures to be associated with high risk

July 20, 2018: EBA consultation on draft guidelines on STS criteria for ABCP securitization

July 20, 2018: EBA consultation on draft guidelines on STS criteria for non-ABCP securitization

July 27, 2018: EBA consultation on draft Guidelines on disclosure of non-performing and forborne exposures

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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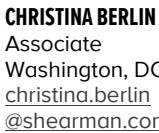
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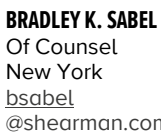
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