

# 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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## Bank Prudential Regulation & Regulatory Capital

### US Federal Financial Regulators Publish Proposed Changes to the Volcker Rule

On July 17, 2018, the U.S. Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Securities and Exchange Commission and Commodity Futures Trading Commission published their previously announced notice of proposed rulemaking entitled *Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds* in the Federal Register. The proposed rules seek to simplify and tailor the Volcker Rule. Comments to the proposal are due by September 17, 2018.

For a more comprehensive discussion of the proposed changes to the Volcker Rule, you may wish to refer to our client publication: “Volcker Rule 2.0: First Major Rule Revisions Proposed” available at:

<https://www.shearman.com/perspectives/2018/06/volcker-rule-2-first-major-rule-revisions-proposed>.

The full text of the proposal is available at: <https://www.gpo.gov/fdsys/pkg/FR-2018-07-17/pdf/2018-13502.pdf>.

### US FDIC Publishes Updates to Interagency Forms

On July 11, 2018, the FDIC announced updates to four of its interagency forms: (i) the Biographical and Financial Report (OMB Control Number 3064-0006); (ii) the Bank Merger Act Application (OMB Control Number 3064-0015); (iii) the Notice of Change in Control form (OMB Control Number 3064-0019); and (iv) the Notice of Change in Director or Senior Executive Officer form (OMB Control Number 3064-0097). The U.S. Board of Governors of the Federal Reserve System also published updated versions of these forms (FR 2081c, FR 2070, FR 2081a and FR 2081b, respectively) to its website on July 11, 2018.

The FDIC announcement notes that these updates are based upon the comments and recommendations of an interagency working group, comprised of representatives from the FDIC, the Federal Reserve Board and the OCC. The changes to the forms were made to improve the clarity of the specific information requested in the forms, provide additional transparency to financial institutions completing the forms, make changes to reflect new laws, regulations, capital requirements and accounting rules and to delete information requests that have been determined to be unnecessary.

The changes to the FDIC forms are effective immediately.

The full text of the FDIC Financial Institution Letter, including links to the updated forms, is available at:

<https://www.fdic.gov/news/news/financial/2018/fil18038.pdf>.

### EU Secondary Legislation Adopted Amending Liquidity Coverage Requirement

On July 13, 2018, the European Commission adopted an Amending Regulation to make amendments to an existing Delegated Regulation (Regulation (EU) 2015/61) supplementing the Capital Requirements Regulation. The existing Delegated Regulation sets out detailed requirements on the Liquidity Coverage Requirement and specifies which assets are to be considered as liquid (so-called high quality liquid assets) and how the expected cash outflows and inflows over a 30-day stressed period are to be calculated.

The European Commission consulted on a draft of the Amending Regulation between January and February 2018. The Amending Regulation makes changes to the existing Delegated Regulation with the objective of improving its practical application, relating to:

- I. full alignment of the calculation of the expected liquidity outflows and inflows on repurchase agreements, reverse repurchase agreements and collateral swaps transactions with the international liquidity standard developed by the Basel Committee on Banking Supervision;
- II. treatment of certain reserves held with third-country central banks;
- III. waiver of the minimum issue size for certain non-EU liquid assets;
- IV. the application of the unwind mechanism for the calculation of the liquidity buffer; and
- V. integration in the existing Delegated Regulation of the new criteria for simple, transparent and standardized securitizations.

The Amending Regulation will now be considered by the European Parliament and the Council of the European Union. It will enter into force twenty days following its publication in the Official Journal of the European Union and will apply directly across the EU 18 months after that date.

The Amending Regulation can be viewed at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4404-F1-EN-MAIN-PART-1.PDF>

### **EU Court Annuls European Central Bank Leverage Ratio Decisions for Six Banks**

On July 13, 2018, the General Court of the European Union annulled decisions of the European Central Bank, refusing to allow six French banks to exclude from the calculation of the leverage ratio certain exposures connected to French savings accounts. Banque Postale, BPCE, Confédération Nationale du Crédit Mutuel, Société Générale, Crédit Agricole and BNP Paribas applied to the ECB, as their direct prudential supervisor under the Single Supervisory Mechanism, for permission to exclude exposures consisting of sums in a number of savings accounts taken out with them and transferred to the Caisse des Dépôts et Consignations, a French public investment vehicle. National regulators and the ECB have discretion to allow banks to exclude exposures that satisfy a number of conditions from the calculation of the leverage ratio under the CRR.

When the ECB refused that permission, the six banks applied for annulment of those decisions. The General Court found that the ECB had erred in law and made manifest errors of assessment in refusing to allow the banks to exclude the exposures.

An appeal, limited to points of law only, may be brought before the Court of Justice against the decision of the General Court within two months of notification of the decision.

The Court's press release is available at: <https://curia.europa.eu/jcms/upload/docs/application/pdf/2018-07/cp180110en.pdf>.

### **UK Prudential Regulator Provides Hurdle Rate Change Information for 2018 Stress Test**

On July 12, 2018, the U.K. Prudential Regulation Authority published a statement on Systemic Risk Buffers and Pillar 2A in stress test hurdle rates. The Bank of England announced in its March 2018 Key Elements of the 2018 Stress Test that it would be making four changes to the way hurdle rates are calculated. Hurdle rates are the level that a firm's capital ratio falls to during a stress scenario relative to the level of capital a

firm is expected to maintain during the scenario. The PRA's statement provides details on two of the ways in which hurdle rates will change: (i) hurdle rates will incorporate buffers to capture domestic systemic importance, in addition to global systemic importance; and (ii) the calculation of minimum capital requirements (incorporated in the hurdle rates) will more accurately reflect how they would evolve in a real stress scenario.

The PRA has not commented on when further details of the other changes to hurdle rates will be published. The BoE expects to publish the results of the stress test in Q4 2018.

The statement is available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/report/systemic-risk-buffers-and-pillar-2a-in-stress-test-hurdle-rates.pdf>.

Details of the Key Elements of the 2018 stress test are available at: <https://finreg.shearman.com/bank-of-england-publishes-details-of-its-2018-str>.

## Brexit for Financial Services

### **UK Government Publishes White Paper on the Future Relationship Between the UK and the EU**

On July 12, 2018, the U.K. Government published a White Paper setting out its approach and proposals for a future relationship between the U.K. and the EU. The Government is proposing new economic and regulatory arrangements for financial services that would give both the EU and the U.K. autonomy over decisions regarding access to its market. The Government acknowledges that both the EU and the U.K. will want to legislate for their own interests to take account of the differences in the EU and U.K. markets, business models as well as financial stability exposures.

The Government does not intend to replicate the existing EU passporting regime, which is reserved for countries falling within the single market. Instead, the Government intends that the new arrangements would be based on an enhanced equivalence regime that would enable the cross-border provision of the most important financial services and would preserve regulatory and supervisory cooperation. The Government states that the existing equivalence frameworks would need to be expanded, because the EU's equivalence regime does not cover the breadth of U.K. and EU financial services provision and because there are no provisions which ensure a transparent and predictable process with lasting effect. Notably, these issues were highlighted by Shearman & Sterling partner, Barnabas Reynolds, in his books, "A Template for Enhanced Equivalence," and "EU-UK Financial Services After Brexit Enhanced Equivalence - A Win-Win Proposition", suggesting that the future U.K. and EU arrangements for financial services should be based on the EU equivalence regime with the gaps filled and the process overhauled to ensure a transparent and robust system. An analysis of the position for each sector of the financial market and the steps needed for equivalence were discussed in our client note, "Brexit and Equivalence: Review of the Financial Services Framework Across All Sectors."

The Government proposes that at the end of the transitional period, i.e., December 31, 2020, reciprocal recognition of equivalence under all existing third-country regimes would take effect. This is intended to give businesses certainty and the ability to plan accordingly. Thereafter, future equivalence determinations would be an autonomous matter for the EU and for the U.K. under a bilateral arrangement.

The bilateral arrangement would include provisions for:

*Common Principles for the Governance of the Relationship*

Equivalence decisions would be based on an evidence-based judgement of the equivalence of outcomes achieved by the respective regulatory and supervisory regimes. The arrangement would include common objectives, such as maintaining economic relations of broad scope and preserving regulatory compatibility and supporting collaboration (both bilaterally and in multilateral fora). The overall aim would be to ensure financial stability and the prevention of regulatory arbitrage.

*Extensive Regulatory Dialogue*

To ensure equivalence is maintained over the long term, the U.K. and the EU would be able to comment on each other's proposals at an early stage through a structured consultative process of dialogue at the political and technical levels. This approach would still respect the autonomy of each side's legislative process and decision-making.

*Extensive Supervisory Cooperation*

Close supervisory cooperation would be necessary for firms posing systemic risk and/or providing significant cross-border services on the basis of equivalence. Both the U.K. and the EU would need to commit to reciprocal and close cooperation to protect consumers, financial stability and market integrity with codified procedures for routine cooperation and for coordination in crisis situations. In addition, there would be reciprocal participation in supervisory colleges and other supervisory structures, including information exchange, mechanisms for consultation over decisions affecting the other party and arrangements for the supervision of financial market infrastructure, such as CCPs, payment systems and trading venues.

*Predictable, Transparent and Robust Processes*

The Government asserts that a transparent process would be needed to ensure the future economic relationship is stable, reliable and enduring. It is envisaged that some of these processes would be bilaterally agreed and treaty-based while others would be achieved through autonomous measures. In particular, the Government proposes:

- I. a transparent assessment methodology for assessing equivalence, based on clear and common objectives. Consultations with industry and other stakeholders and the potential use of expert panels would be a part of the process.
- II. a structured withdrawal process in the event that either party wished to withdraw equivalence or if one party no longer sought equivalence in a particular area. This would include an initial period of consultation on possible solutions to maintain equivalence, clear timelines and notice periods, which are appropriate for the scale of the change before it takes effect. It would also be imperative to build-in safeguards for acquired rights to avoid risks to financial stability, market integrity or consumer protection.
- III. a presumption, in line with WTO principles, against unilateral changes that attempt to narrow the terms of existing market access regimes, other than in exceptional circumstances. This would include avoiding future changes to the way equivalence is assessed and requiring a new decision to be taken before an existing equivalence decision lapsed.

None of these proposals have been subject to the latest round of close votes in the U.K. parliament. The U.K. Government's move from the "mutual recognition" approach to an equivalence one reflects the EU's position

more closely, as evidenced by Michel Barnier's recent speech at the European American Chamber of Commerce in New York. The EU has stated that it is considering the proposals.

The White Paper is available at:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/725288/The\\_future\\_relationship\\_between\\_the\\_United\\_Kingdom\\_and\\_the\\_European\\_Union.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725288/The_future_relationship_between_the_United_Kingdom_and_the_European_Union.pdf) and Mr. Barnier's speech is available at: [http://europa.eu/rapid/press-release\\_SPEECH-18-4452\\_en.htm](http://europa.eu/rapid/press-release_SPEECH-18-4452_en.htm).

You may like to see Mr. Reynolds' book, "A Template for Enhanced Equivalence" and "EU-UK Financial Services After Brexit Enhanced Equivalence - A Win-Win Proposition". Both books provide greater detail on how the equivalence based approach can be used to achieve many of the Government's proposals, available at: <http://www.politeia.co.uk/wp-content/Politeia%20Documents/Unpublished/A%20Template%20for%20Enhanced%20Equivalence%20-%20Reynolds%20-%20July%202017.pdf> and [http://europeanreform.org/files/EU\\_UK\\_Financial\\_Services.pdf](http://europeanreform.org/files/EU_UK_Financial_Services.pdf).

You may wish to see our client note, "Brexit and Equivalence: Review of the Financial Services Framework Across All Sectors," available at: <https://www.shearman.com/-/media/Files/NewsInsights/Publications/2016/08/Brexit-and-Equivalence-Review-of-the-Financial-Services-Framework-Across-All-Sectors-FIAFR-081016.pdf> and other Brexit-related materials, available at: <https://www.shearman.com/key-issues/brexit-resource-center?section=perspectives>.

### **EU Authority Urges UK Financial Institutions to Apply for EU Authorizations Now**

On July 12, 2018, the European Securities and Markets Authority issued a public statement urging U.K.-based financial institutions to prepare for a hard Brexit. In particular, ESMA states that firms wishing to continue providing services across the EU after the U.K. has exited the EU must make timely applications for authorization to the relevant national regulators in the EU member state in which the firm wants to relocate its business. ESMA notes that it has seen an increase in applications being made and highlights that some national regulators have stipulated that applications needed to be received in June/July 2018 for approval to be granted in time.

The ESMA's statement is available at: <https://www.esma.europa.eu/press-news/esma-news/esma-reminds-uk-based-regulated-entities-about-timely-submission-authorisation>.

## **Conduct & Culture**

### **FICC Markets Standards Board Consults on Statement of Good Practice on Algorithmic Trading**

On July 11, 2018, the FICC Markets Standards Board launched a consultation on a transparency draft of a Statement of Good Practice on algorithmic trading in the wholesale fixed income, commodity and currency markets. The draft SGP forms part of the FMSB's work to build up a body of Standards and Statements of Good Practice to improve conduct and raise standards in the wholesale FICC markets. The FMSB Standards and SGPs do not impose legal or regulatory obligations on FMSB members, nor do they take the place of regulation. Instead, an SGP is intended to be considered to the extent it is possible to follow it in compliance with applicable laws.

For the purposes of the consultation paper, "algorithmic trading" is defined as trading in instruments where a computer algorithm, with limited or no human intervention, automatically determines individual parameters of

orders, such as whether to initiate the order, the timing, price or quantity of the order or how to manage the order after its submission.

In the consultation paper, the FMSB explains how algorithms are used by dealers, brokers, clients and venues in a variety of ways and that new uses are evolving. The FMSB notes that the revised Markets in Financial Instruments Directive and the Markets in Financial Instruments Regulation (known as MiFID II) contain certain provisions on algorithmic trading that are similar to those in the draft SGP. The SGP is intended to set out high-level good practice statements for the use of algorithms in all FICC businesses, wherever carried on, including in cases where the activity is not within the scope of MiFID II, such as trading of spot FX or physical commodities outside regulated trading venues. The draft SGP sets out nine good practice statements covering the following aspects: (i) overarching governance structure; (ii) minimum standards relevant to algorithmic trading and algorithmic trading systems; (iii) inventories and definitions; (iv) risk management and controls; (v) policies and procedures; (vi) software development and change process; (vii) ongoing oversight within the governance structure; (viii) record keeping; and (ix) training and education of relevant personnel.

The FMSB invites comments on the transparency draft by September 7, 2018. The FMSB expects to finalize the SGP shortly after the close of the consultation.

The draft statement of good practice is available at: [https://fmsb.com/wp-content/uploads/2018/07/Algorithmic-Trading\\_SGP\\_TD\\_v12.pdf](https://fmsb.com/wp-content/uploads/2018/07/Algorithmic-Trading_SGP_TD_v12.pdf) and the FMSB press release is available at: <https://fmsb.com/ficc-markets-standards-board-fmsb-issues-new-statement-of-good-practice-on-algorithmic-trading/>.

## Derivatives

### **EU Consultation on Extending the Exemption From the Clearing Obligation for Intragroup Transactions With Third-Country Group Entities**

On July 11, 2018, ESMA opened a consultation on the exemption from the clearing obligation for intragroup transactions with a third-country group entity. There are three Regulatory Technical Standards made under the European Market Infrastructure Regulation that provide for the clearing obligation of interest rate derivatives and credit derivatives—the RTS on the clearing obligation for IRS denominated in G4 currencies, the RTS on the clearing obligation for IRS denominated in certain other currencies and the RTS on the clearing obligation for CDS. Each of the RTS also exempt intragroup derivative transactions with third-country group entities that meet certain conditions from the clearing obligation where one of the counterparties is a third-country group entity and there is no relevant equivalence decision. An equivalence decision enables parties subject to both the EU and a third country's clearing obligation to only comply with one jurisdiction's requirements.

Each of the RTS sets a different expiry date for the exemption period. These dates are:

- I. December 21, 2018 in the RTS on the clearing obligation for IRS denominated in G4 currencies (RTS 2015/2205);
  - II. May 9, 2019 in the RTS on the clearing obligation for CDS (RTS 2015/592); and
  - III. July 9, 2019 in the RTS on the clearing obligation for IRS denominated in certain other currencies (RTS 2016/1178).
- Text



Comments on the proposals should be provided by August 30, 2018. ESMA will consider the feedback in finalizing the draft amending RTS for submission to the European Commission.

The consultation paper is available at: <https://www.esma.europa.eu/press-news/esma-news/esma-consults-clearing-obligation-under-emir>.

### **Financial Stability Board Welcomes ISDA Consultation on Fallbacks Risk-Free Rates for Derivatives**

On July 12, 2018, the Financial Stability Board published a statement welcoming the consultation by the International Swaps and Derivatives Association on fallbacks based on overnight risk-free rates for certain derivative contracts. The statement has been issued to provide market participants with the FSB's views ahead of the consultation by ISDA. The FSB's view is that overnight RFRs are more robust than interbank or term rates, because they are based on active and liquid underlying markets. Overnight RFRs are considered by the FSB to be a better choice than term rates for markets where participants do not need forward-looking term rates. The FSB stated that for those markets where the IBOR may cease, citing the example of LIBOR, a transition to new reference rates will be crucial. The FSB acknowledges the work to reform some IBORS excluding LIBOR. It is therefore unclear whether the FSB has factored in the recently announced changes to LIBOR methodology in making this assessment and reaching these conclusions.

The FSB is concerned that RFR-derived term rates may not have sufficient liquidity to support the production of a benchmark across all market conditions and that this fall back, as an alternative to the existing use of IBORs, would not address the systemic risks. Therefore, the FSB welcomes ISDA's consultation on the use of fallbacks based on the overnight RFRs.

The FSB also highlights the need for a transition to new reference rates and thinks that this could best be achieved by including the overnight RFRs as the reference rate in new transactions.

The FSB will publish a full report on progress of benchmark reforms in November 2018.

The FSB's statement is available at: <http://www.fsb.org/wp-content/uploads/P120718.pdf> and the FSB's press release is available at: <http://www.fsb.org/2018/07/fsb-issues-statement-on-reforms-to-interest-rate-benchmarks/>.

### **International Swaps and Derivatives Association Consults on Overnight Risk-Free Rate Fallbacks**

On July 12, 2018, the International Swaps and Derivatives Association launched a consultation in which it proposes to amend its standard documentation to implement fallbacks based on alternative risk-free rates for certain key Interbank Offered Rates - GBP LIBOR, CHF LIBOR, JPY LIBOR, TIBOR, Euroyen TIBOR and BBSW. ISDA states that the backups will apply if the relevant IBOR is permanently discontinued based on defined triggers.

ISDA is seeking feedback on the approach to address certain technical issues arising from the necessary adjustments that will apply to the RFRs if the fallbacks are triggered.

ISDA intends to consult on the technical issues for these changes for derivatives referencing USD LIBOR, EUR LIBOR and EURIBOR at a later date. It requests preliminary feedback on the technical issues associated with fallbacks for these benchmarks in this consultation.

Responses to the consultation should be submitted by October 12, 2018. ISDA will determine which approach to adopt based on the feedback and will publish the final approach for review and comment before implementing any changes to the ISDA standard documentation.



The FSB issued a statement on the same day welcoming ISDA's consultation and encouraging market participants to respond to the proposals.

The ISDA's consultation is available at: <http://assets.isda.org/media/f253b540-193/42c13663-pdf/>.

## Enforcement

### Two Bankers Found Guilty by UK Court of Manipulating EURIBOR

On July 12, 2018, the U.K.'s Serious Fraud Office announced that two former bankers have been found guilty by a jury of conspiracy to defraud for manipulating the Euro Interbank Offered Rate (EURIBOR). One other former banker has been found not guilty by a jury. The findings follow an investigation launched by the SFO 2012.

The jury could not reach verdicts on the case of three other bankers. By July 20, 2018, the SFO will inform the court whether it intends to proceed with a retrial. The two convicted bankers will be sentenced on July 20, 2018.

The SFO's press release is available at: <https://www.sfo.gov.uk/2018/07/12/two-former-senior-bankers-convicted-of-fraud-in-sfos-euribor-manipulation-case/>.

## Funds

### EU Secondary Legislation for Money Market Funds Published

On July 13, 2018, a Commission Delegated Regulation amending and supplementing the European Money Market Funds Regulation was published in the Official Journal of the European Union. The MMF Regulation, which applies directly across the EU from July 21, 2018, allows MMFs to invest in securitizations or asset-backed commercial paper and incentivizes the investment in simple, transparent and standardized securitizations. The Delegated Regulation amends the MMF Regulation by applying the requirements for STS securitizations provided for in the Securitization Regulation (also known as the STS Regulation).

The MMF Regulation also allows an MMF to enter into a reverse repurchase agreement provided that certain conditions are met. The assets received by the MMF under that agreement must be money market instruments that meet certain requirements. A derogation from those requirements provides that an MMF may also receive instruments that are either: (i) issued or guaranteed by the EU, a central authority or central bank of a Member State, the ECB, the European Investment Bank, the European Stability Mechanism or the European Financial Stability Facility; or (ii) issued or guaranteed by a central authority or central bank of a third country. The Delegated Regulation supplements the MMF Regulation by providing the quantitative and qualitative liquidity requirements for the assets that an MMF receives under a reverse repurchase agreement where the derogation is being used.

The MMF Regulation empowers the European Commission to adopt delegated acts that aim to ensure that MMFs are invested in appropriate eligible assets by further specifying the credit quality assessments of money market instruments, securitizations and ABCPs that MMFs may undertake or invest in. The Delegated Regulation includes these provisions by setting out: (i) the criteria for the validation of the credit quality assessment methodology; (ii) the criteria for quantification of the credit risk and of the relative risk of default of an issuer and of the instrument; (iii) the criteria for establishing qualitative indicators on the issuer of the

instrument; and (iv) the meaning of ‘material change’ as referred to in the requirement for an MMF to conduct a new credit quality assessment for a money market instrument, securitization and ABCP when there is a material change that could have an impact on the existing assessment of the instrument.

The Delegated Regulation will apply from July 21, 2018, except for the provision cross-referring to the Securitization Regulation, which will apply from January 1, 2019 to align it with the application date of that Regulation.

The amending Regulation is available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R0990&from=EN>.

### **EU Adopted Regulations Clarifying Duties of Third-Party Custodians Safe-Keeping Fund Assets**

On July 12, 2018, the European Commission adopted revisions to the Delegated Regulations on the safe-keeping duties of depositaries under both the Alternative Investment Fund Managers Directive and the Undertakings for Collective Investment in Transferable Securities Directive. The Commission consulted on the proposed changes between May 29 and June 26, 2018. Following feedback received during that consultation, the Commission has agreed to defer the date from which the revisions will apply to 18 months after publication in the Official Journal of the European Union. It had been proposed that the revisions would apply from six months of publication. In addition, the Commission has made certain changes to the text to improve the clarity of the requirements without introducing any further substantive changes.

The adopted Delegated Regulations are subject to review by the European Parliament and the Council of the European Union. If there is no objection from either of those bodies, the revised Delegated Regulations should apply directly across the EU from Spring 2020.

The amending Delegated Regulation under AIFMD is available at: [http://ec.europa.eu/finance/docs/level-2-measures/aifmd-delegated-regulation-2018-4377\\_en.pdf](http://ec.europa.eu/finance/docs/level-2-measures/aifmd-delegated-regulation-2018-4377_en.pdf), the amending Delegated Regulation under UCITS is available at: [http://ec.europa.eu/finance/docs/level-2-measures/ucits-directive-delegated-regulation-2018-4379\\_en.pdf](http://ec.europa.eu/finance/docs/level-2-measures/ucits-directive-delegated-regulation-2018-4379_en.pdf) and details of the proposed revisions to the Delegated Regulations are available at: <https://finreg.shearman.com/eu-consultation-on-duties-of-third-party-custodia>.

### **UK Regulator Confirms UK Rule Alignments for the EU Money Market Funds Regulation**

On July 11, 2018, the U.K. Financial Conduct Authority published a Policy Statement outlining the rule changes necessary to align its rulebook with the provisions of the EU MMF Regulation.

The FCA has made changes to amend, delete or disapply rules in its Handbook to MMFs to ensure those rules do not conflict with the MMF Regulation. The regulator consulted on the proposed changes between January and March 2018. The amended rules apply from July 21, 2018 to new MMFs, including funds with substantially similar objectives to MMFs, once they are authorized as MMFs under the MMF Regulation. Funds already operating as either MMFs or funds falling within the current definition of short-term money market funds in the FCA’s rules will benefit from transitional provisions and will have until July 21, 2019 to apply for authorization under the MMF Regulation.

The MMF Regulation takes effect directly across the EU from July 21, 2018. The effect of the MMF Regulation in the U.K. will be that authorized unit trusts, authorized contractual schemes, open-ended investment companies and alternative investment funds can all apply to be authorized as MMFs. As a directly applicable EU regulation, the MMF Regulation does not require transposition into national law. However, these changes

have been made to ensure the U.K. rules are in line with EU laws and empower the FCA to authorize funds as MMFs, to levy fees and to enforce requirements under the MMF Regulation.

The Policy Statement (FCA PS 18/17) is available at: <https://www.fca.org.uk/publication/policy/ps18-17.pdf>, details of the FCA consultation on proposed Handbook changes are available at: <https://finreg.shearman.com/uk-financial-conduct-authority-proposes-handbook-> and details of the U.K. implementing regulations for the MMF Regulation are available at: <https://finreg.shearman.com/uk-implementing-regulations-for-the-money-market->.

## MiFID II

### EU Proposes Amendments to MiFID II's Tick Size Regime

On 13 July, 2018, ESMA launched a consultation on proposed amendments to the RTS (Commission Delegated Regulation (EU) 2017/588, also known as RTS 11) providing for the tick size regime under MiFID II. The tick size regime subjects orders in shares and depositary receipts to minimum tick sizes that are determined according to both the: (i) average daily number of transactions on the most relevant market in terms of liquidity; and (ii) price of the order. RTS 11 calibrates the minimum tick size based on the most liquid market in the EU, without any consideration being given to the liquidity on non-EU trading venues. The result is that EU trading venues have experienced a drop in market share in third-country financial instruments since January 3, 2018 when MiFID II came into effect. The trading venues have highlighted that the decrease in market share is because the RTS 11 methodology requires them to have in place larger price increments than those of their third-country competitor trading venues.

ESMA is proposing to change the calibration of the tick sizes for third-country instruments where the most liquid trading venue is located outside the EU to address the concern that the minimum tick size is based on “underestimated” liquidity for financial instruments where only a marginal proportion of trading is executed on EU trading venues. ESMA’s belief is that the existing situation has the potential to create a competitive disadvantage for EU trading venues, because non-EU trading venues can offer tighter spreads since they are likely to be subject to a narrower tick size regime or none at all. The result may be less liquidity on EU trading markets.

ESMA proposes that national regulators of EU trading venues trading a third-country instrument be allowed to coordinate and to agree on an adjusted average daily number of transactions that reflects the liquidity available on third-country venues on a case-by-case basis. This proposed exception to the general tick size regime would only be applicable to shares that meet certain conditions. Depositary receipts will be out of scope of the exception.

Feedback on the proposals is requested by September 7, 2018. ESMA will consider the feedback in formulating the final draft amending RTS it submits to the European Commission for endorsement.

ESMA’s consultation is available at: <https://www.esma.europa.eu/press-news/esma-news/esma-consults-tick-size-regime>.

## Recovery & Resolution

### UK Special Administration Regime for Financial Market Infrastructure Brought Into Force

On July 12, 2018, a U.K. Order, the Financial Services (Banking Reform) Act 2013 (Commencement No. 1) (England and Wales) Order 2018, was made. The Order brings into force, from July 13, 2018, the provisions in the Financial Services (Banking Reform) Act 2013 relating to the special administration regime for operators of financial market infrastructures. Relevant FMIs are operators of recognized payment systems, excluding recognized CCPs (which are already subject to the Banking Act resolution regime in the U.K.) and recognized central securities depositories operating a securities settlement system.

On the same day, the Financial Market Infrastructure Administration (England and Wales) Rules 2018 were laid before Parliament. The Rules follow the consultation carried out by the U.K. Government in 2016 on proposed changes to the insolvency rules. The Government published, on July 10, 2018, its response to the feedback it received to the proposed Rules. The Rules, which come into force on August 4, 2018, amend the normal insolvency rules to include as an objective of the administrator of an FMI subject to the special administration regime, that of maintaining critical services. The usual insolvency rules provide for an administrator to focus on the best interests of creditors. The Rules grant the Bank of England a primary role in the administration to ensure that services are maintained.

The Order is available at:

[http://www.legislation.gov.uk/ukxi/2018/848/pdfs/ukxi\\_20180848\\_en.pdf?\\_sm\\_au\\_=iVVGZrQPRrJNrrD6](http://www.legislation.gov.uk/ukxi/2018/848/pdfs/ukxi_20180848_en.pdf?_sm_au_=iVVGZrQPRrJNrrD6), the

Rules are available at: <http://www.legislation.gov.uk/ukxi/2018/833/made>, the Government's consultation page on the proposed Rules is available at: <https://www.gov.uk/government/consultations/rules-on-ensuring-the-effective-functioning-of-a-financial-market-infrastructure-special-administration-regime/rules-on-ensuring-the-effective-functioning-of-a-financial-market-infrastructure-special-administration-regime> and details of the Government's consultation are available at: <https://finreg.shearman.com/hm-treasury-consults-on-new-rules-for-financial-m>.

## Securities

### EU Consultation on Minimum Standards for an Exemption From Providing a Prospectus

On July 13, 2018, ESMA published a consultation paper on its draft technical advice to the European Commission on the minimum information content of documents provided for the purpose of describing a takeover, merger or division. ESMA was mandated by the Commission in February 2017 to provide it with technical advice for the circumstance where, under the Prospectus Regulation, issuers can benefit from an exemption to the requirement to supply a prospectus when they offer or admit securities connected with a takeover, merger or division. Issuers may, as an alternative to a prospectus, make available to investors an alternative document, which describes the transaction and its impact on the issuer.

ESMA's technical advice sets out the minimum information content of documents describing a merger, division or takeover which is necessary for an exemption from the obligation to publish a prospectus. ESMA invites comments on a range of questions on the content of the following sections of such "exempted documents": (i) operative provisions and definitions; (ii) Minimum Information Content Simplified Disclosure Regime for the Issuer; (iii) the Minimum Information Content Securities; (iv) the Minimum Information Content Description and Impact of Takeover, Merger and Division.

The consultation on the draft technical advice closes on October 5, 2018. ESMA expects to publish its final report on its technical advice in Q1 2019.

The consultation paper can be viewed at: [https://www.esma.europa.eu/sites/default/files/library/esma31-62-962\\_consultation\\_paper\\_on\\_minimum\\_information\\_content\\_for\\_prospectus\\_exemption.pdf](https://www.esma.europa.eu/sites/default/files/library/esma31-62-962_consultation_paper_on_minimum_information_content_for_prospectus_exemption.pdf).

### **EU Consultation on Proposed Risk Factors Guidelines Under the Prospectus Regulation**

On July 13, 2018, ESMA published a consultation paper setting out draft guidelines for national regulators on risk factors under the Prospectus Regulation. ESMA has prepared the draft guidelines following a mandate from the European Commission to assist national regulators in their review of the specificity and materiality of risk factors within prospectuses and of the presentation of risk factors across categories depending on their nature.

The draft guidelines cover (i) specificity; (ii) materiality; (iii) corroboration of the materiality and specificity; (iv) presentation of risk factors across categories; (v) focused/concise risk factors; and (vi) risk factors in the summary. Comments on the draft guidelines are invited by October 5, 2018.

The consultation paper can be viewed at: [https://www.esma.europa.eu/sites/default/files/library/esma31-62-996\\_consultation\\_paper\\_on\\_guidelines\\_on\\_risk\\_factors.pdf](https://www.esma.europa.eu/sites/default/files/library/esma31-62-996_consultation_paper_on_guidelines_on_risk_factors.pdf).

### **European Commission Adopts Technical Standards Under the EU Benchmarks Regulation**

On July 13, 2018 the European Commission adopted a series of Commission Delegated Regulations comprising all of the RTS to supplement the EU Benchmarks Regulation.

The Benchmark Regulation, which took effect across the EU in January 2018, sets out the authorization and registration requirements for benchmark administrators, including third-country entities, and the requirements for governance and control of administrators. It provides for different categories of benchmarks depending on the risks involved, imposes additional requirements on benchmarks considered to be “critical” and gives powers to national regulators to mandate, under certain conditions, contributions to or the administration of critical benchmarks. The RTS outline the behaviors and standards expected of administrators of and contributors to benchmarks. The RTS adopted by the Commission are based on draft RTS prepared by ESMA in March 2017.

The European Parliament and the Council of the European Union will now have three months in which to raise any objections to the Delegated Regulations. The Delegated Regulations will take effect 20 days after their publication in the Official Journal of the European Union.

The RTS cover the following areas:

- I. The procedures and characteristics of the oversight function for benchmark administrators.
- II. The appropriateness and the verifiability of input data, together with the internal oversight and verification procedures of a contributor.
- III. The information to be provided by an administrator of a critical or significant benchmark about the benchmark and methodology.
- IV. The elements of the code of conduct for contributors.
- V. The requirements concerning governance, systems and controls.

- vi. The criteria that a national regulator should take into account when deciding whether a critical benchmark administrator should apply certain additional requirements.
- vii. The contents of the benchmark statement and the cases in which an update of such a statement is required.
- viii. The minimum content of the cooperation arrangements between ESMA and third-country national regulators whose legal framework and supervisory practices have been recognized as equivalent.
- ix. The form and content of an application for recognition of a third-country administrator and presentation of the information that is to be provided with the application.
- x. The information to be provided on an application for authorization or registration

The RTS on the oversight function is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4430-F1-EN-MAIN-PART-1.PDF> and its Annex is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4430-F1-EN-ANNEX-1-PART-1.PDF>.

The RTS on appropriateness and the verifiability of the input data is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4431-F1-EN-MAIN-PART-1.PDF>.

The RTS on information on critical or significant benchmarks and methodology is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4435-F1-EN-MAIN-PART-1.PDF>.

The RTS on elements of the code of conduct for contributors is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4432-F1-EN-MAIN-PART-1.PDF>.

The RTS on requirements on governance, systems and controls and policies for supervised contributors is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4425-F1-EN-MAIN-PART-1.PDF>.

The RTS on criteria a national regulator should consider when assessing whether a benchmark administrator should apply certain requirements is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4434-F1-EN-MAIN-PART-1.PDF>.

The RTS on benchmark statements is available at: <https://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4439-F1-EN-MAIN-PART-1.PDF>.

The RTS on minimum content of cooperation arrangements between ESMA and third-country national regulators is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4427-F1-EN-MAIN-PART-1.PDF>.

The RTS on the form and content of an application for recognition is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4426-F1-EN-MAIN-PART-1.PDF>.

The Annex to the RTS on the form and content of an application for recognition is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4426-F1-EN-ANNEX-1-PART-1.PDF>.

The RTS on information to be provided on an application for authorization or registration is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4438-F1-EN-MAIN-PART-1.PDF> and its Annex is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-4438-F1-EN-ANNEX-1-PART-1.PDF>.

### **UK Legislation Published to Permit Islamic Bonds to Be Traded on More Venues**

On July 10, 2018, the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2018 was made and came into force on July 11, 2018. The Order amends the definition of “Alternative Finance Investment Bonds” in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. The result of the amendment is that AFIBs, such as Sukuk, will be permitted to trade on multilateral trading facilities or organised trading facilities and ensure AFIBs are treated in the same way as conventional bonds for trading purposes.

The amendment removes a glitch creating disparity of treatment between AFIBs and conventional bonds, which had created an obstacle to the use of U.K. venues for the issue and trading of AFIBs. This was contrary to the U.K. Government’s standing commitment to provide a level playing field for Islamic finance instruments in regulation and taxation in the U.K.

The Order also amends the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 so that a person administering a benchmark as specified in the RAO will be regarded as carrying on the activity by way of business and will therefore require authorization under the Financial Services and Markets Act 2000 to do so.

The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2018 (SI 2018/831) is available at: [http://www.legislation.gov.uk/ukxi/2018/831/pdfs/ukxi\\_20180831\\_en.pdf](http://www.legislation.gov.uk/ukxi/2018/831/pdfs/ukxi_20180831_en.pdf) and the explanatory memorandum is available at: [http://www.legislation.gov.uk/ukxi/2018/831/pdfs/ukxiem\\_20180831\\_en.pdf](http://www.legislation.gov.uk/ukxi/2018/831/pdfs/ukxiem_20180831_en.pdf).

### **Upcoming Events**

July 25, 2018: EBA public hearing on draft Guidelines on the conditions to be met to benefit from an exemption from contingency measures under the RTS on strong customer authentication and common and secure communication

July 31, 2018: ECB public hearing on a draft Regulation proposing the materiality threshold for credit obligations past due under the CRR

September 4, 2018: EBA public hearing on its consultation on draft RTS for calculation of KIRB for securitized exposures

September 4, 2018: EBA public hearing on its consultation on draft Guidelines on outsourcing arrangements

September 4–5, 2018: OECD blockchain conference: Unleashing the potential and facing the challenges of blockchain (registration closes August 30, 2018)

October 15, 2018: SRB Conference 2018—10 years after the crisis: are banks now resolvable?

November 28, 2018: EBA 7th Annual Research Workshop—Reaping the benefits of an integrated EU banking market

### **Upcoming Consultation Deadlines**

July 24, 2018: European Commission proposal for a regulation on Sovereign Bond-Backed Securities

July 24, 2018: European Commission consultation on a proposed Regulation amending the Benchmarks Regulation



July 25, 2018: European Commission consultation on a proposal for Regulation amending MAR and the PR to promote SME Growth Markets

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

August 13, 2018: EBA consultation on draft Guidelines on the conditions to be met to benefit from an exemption from contingency measures under the RTS on strong customer authentication and common and secure communication

August 17, 2018: ECB consultation on a draft Regulation proposing the materiality threshold for credit obligations past due under the CRR

August 17, 2018: FATF consultation on draft Risk-Based Approach Guidance for the securities sector

August 20, 2018: FSB call for feedback on the technical implementation of the TLAC Standard

August 20, 2018: FSB consultation on a draft cyber lexicon

August 22, 2018: PRA consultation on Securitization: the new EU framework and significant risk transfer

August 30, 2018: ESMA consultation on extending the exemption from the clearing obligation for intragroup transactions with third-country group entities

September 3, 2018: PSR discussion paper on use of data in the payments industry

September 4, 2018: CFTC's proposed amendments to SRO surveillance programs for FCMs

September 4, 2018: Comment deadline for the U.S. Federal Reserve Board's Fedwire Funds Service new message format proposal

September 7, 2018: ESMA consultation on amendments to the MiFID II tick size regime

September 7, 2018: FSMB consultation on a draft statement of good practice on algorithmic trading

September 17, 2018: Comment deadline for Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (proposed changes to the Volcker Rule)

September 19, 2018: EBA consultation on draft RTS for calculation of KIRB for securitized exposures

September 24, 2018: EBA consultation on draft Guidelines on outsourcing arrangements

September 25, 2018: PRA consultation on reflecting the Systemic Risk Buffer framework within the Leverage Ratio framework for U.K. systemic ring-fenced bodies

October 5, 2018: ESMA consultation on draft guidelines on risk factors under the Prospectus Regulation

October 5, 2018: BoE/PRA/FCA Discussion Paper on operational resilience of firms and FMIs

October 5, 2018: FCA consultation on a new workers directory

October 12, 2018: ISDA consultation on fallbacks based on overnight risk-free rates for certain derivatives

**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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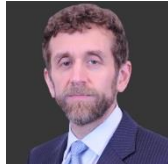
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