

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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Brexit for Financial Services

Post-Brexit UK Secondary Legislation Published for Temporary Permissions Regime for Payments Services

On September 5, 2018, HM Treasury published draft statutory instruments on the regulation of payments and e-money and on access to the Single Euro Payments Area in preparation for the U.K.'s withdrawal from the EU – the draft Electronic Money, Payment Services and Payment Systems (Amendment and Transitional Provisions) (EU Exit) Regulations 2018 and the Credit Transfers and Direct Debits in Euro (Amendment) (EU Exit) Regulations 2018. The draft Regulations are relevant to all Payment Service Providers and registered Account Information Service Providers. The draft Regulations will amend the Payment Services Regulations 2017, Electronic Money Regulations 2011 and the SEPA Regulation to:

I. Create a temporary permissions regime for EEA payment firms

In line with the proposed temporary permissions regime for EEA firms regulated under the Financial Services and Markets Act 2000 (covered by the draft EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018), HM Treasury is proposing a TPR for payments. EEA firms operating under the TPR for payments will need to establish a U.K. subsidiary at the end of the proposed three-year TPR period. This provision should give firms the time to fully operationalize their new U.K. subsidiary.

II. Ensure access to segregated safeguarding accounts

The EU Payment Services Regulations require payment institutions and e-money firms to safeguard consumer funds in the event of an insolvency. One method for doing so is to hold the funds in a segregated account with a EU bank so that if the payment institution or e-money firm goes into insolvency, the customers' funds will be paid out in priority to other creditors. HM Treasury is proposing to allow, subject to certain conditions being met, these firms to hold such safeguarding accounts at banks incorporated anywhere in the world.

III. Maximize the prospect of the U.K. maintaining access to SEPA

This will be achieved by retaining the same operative provisions as are applicable under the EU SEPA Regulation and making certain changes to account for the U.K. accessing SEPA as a third country instead of as an EU Member State. In addition, the EU PSR will be amended so that relevant sections will continue to apply in full to transactions in Euro within SEPA, including intra-U.K.-EU transactions. Should the U.K. not be able to continue its participation in SEPA, it is proposed that HM Treasury is granted a power to remove the SEPA Regulation from U.K. laws and to apply the PSR requirements only to the part of a Euro transaction that is carried out in the U.K.

HM Treasury is proposing not to retain the EU Cross-Border Payments Regulation on the basis that cross-border transactions will not be regulated under U.K. regulation and compliance with the requirements is unnecessary for third-country membership of SEPA. The U.K. government will assess whether this approach needs to be adopted once the proposed changes to the Cross-Border Payments Regulation have been finalized. HM Treasury has confirmed that draft regulations onshoring the Interchange Fee Regulation will be issued at a later date.

HM Treasury intends to lay the draft Regulations before Parliament in the autumn. The Financial Conduct Authority is expected to consult in the autumn on changes to its Handbook as a result of the draft Regulations and to reflect the relevant EU Technical Standards. The draft Regulations will not take effect on March 29, 2019 (Exit Day) if the EU and the U.K. agree an implementation period.

The draft Regulations and the explanatory guidance are available at:

<https://www.gov.uk/government/publications/eu-exit-sis-for-payment-services-e-money-and-the-sepa-regulation> and details of the TPR for FSMA firms are available at: <https://finreg.shearman.com/uk-secondary-legislation-published-for-post-brexit>.

Derivatives

EU Disagreement on EU Technical Standards for Reporting of Securities Financing Transactions

On September 5, 2018, the European Securities and Markets Authority published an Opinion on the European Commission's proposed amendments to the final draft Implementing and Regulatory Technical Standards on reporting under the Securities Financing Transactions Regulation. Various parts of the SFTR came into effect on January 12, 2016. However, the new reporting obligation for SFTs is not yet in force. Securities financing transactions involve the use of securities to borrow cash or other higher investment-grade securities, or vice versa. Such transactions can include repurchase transactions, securities lending and sell/buy backs. The SFTR requires, amongst other things, all securities financing transactions to be reported to EU recognized trade repositories, including details on the composition of collateral, whether collateral is available for reuse or has been reused, the substitution of collateral and any haircuts applied. The reporting obligation will apply to financial and non-financial counterparties, subject to exceptions for central banks and similar bodies.

On March 30, 2017, ESMA submitted its final draft RTS and ITS on the reporting obligation for the SFTR to the European Commission for endorsement. The final draft technical standards included provisions mandating the use of future industry standards on legal entity identifiers for branches and unique trade identifiers for transactions for reporting to trade repositories once the standards had been endorsed by ESMA. The provisions followed the approach to capturing expected forthcoming developments under the European Market Infrastructure Regulation.

On July 24, 2018, the Commission informed ESMA by letter that it intended to endorse the draft RTS and ITS with amendments. The Commission proposes to remove from the technical standards the references to "endorsements by ESMA" of potentially forthcoming industry standards. The proposed amendments would ensure that any changes to the SFTR reporting obligation as a result of industry standards would need to be made through the full EU legislative process instead of ESMA "endorsing" such standards. In addition, the Commission has also requested ESMA to submit proposed amendments to the ITS on the reporting requirements under EMIR to align the procedure for incorporating future industry standards with the Commission's approach under the SFTR.

ESMA's Opinion states that the Authority does not agree with the Commission's proposed amendments to the SFTR reporting technical standards. ESMA's view is that the Commission's proposed amendments would: (i) prevent ESMA from taking into account international developments and reporting standards agreed at global level; (ii) create the risk that the EU reporting requirements would not be implemented in parallel with international reporting standards; and (iii) not provide legal certainty or predictability. ESMA also notes that the EMIR reporting standards have already been agreed upon by the Commission, the European Parliament and the Council of the European Union. On that basis, ESMA requests the Commission to adopt the SFTR reporting technical standards in the original form in which they were submitted by ESMA in March 2017.

The ESMA's Opinion and the Commission's letter are available at: <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-opinion-proposed-amendments-sftr-technical-standards> and the final draft technical standards submitted by ESMA are available at: <https://finreg.shearman.com/european-sees-and-markets-authority-publish>.

Enforcement

Five Individuals Imprisoned for £2.8 Million UK Investment Fraud

On September 4, 2018, five defendants were, between them, sentenced to a total of 17.5 years' imprisonment following a fraud prosecution brought by the U.K. FCA.

The FCA's statement announcing the sentencing highlights the investigation as one of the FCA's most complex fraud investigations to date and the first FCA prosecution of an offense of perverting the course of justice. Between July 2010 and April 2014, the defendants cold-called members of the public and subjected them to high-pressure sales tactics to persuade them to purchase shares in a company that owned land in Madeira. A number of entirely false claims were made to persuade potential investors to invest. Many of the investors were elderly and vulnerable and suffered life-changing losses.

The FCA proposes to commence confiscation proceedings against the five defendants under the Proceeds of Crime legislation. A sixth defendant will be sentenced on September 14, 2018.

The FCA press release is available at: <https://www.fca.org.uk/news/press-releases/five-sentenced-fca-prosecution-28m-investment-fraud>.

FinTech

European Supervisory Authorities Report on Automation in Financial Advice

On September 5, 2018, the Joint Committee of the European Supervisory Authorities published a joint report on automation in financial advice. The Report follows the ESA's 2015 joint discussion paper and follow-up report in 2016. The Report provides a summary of recent sectoral work by the ESAs in this area and the main findings of a survey with national regulators on the evolution of automation in financial advice in the securities, banking and insurance sectors. The ESAs observed that automated services are more often offered through partnerships between established financial intermediaries and FinTech firms than by FinTech firms alone. The ESAs also found that automation in financial advice has grown slowly and that the number of firms and customers involved is still limited. As a result, the ESAs do not consider that any of the previously identified risks have materialized and therefore that further action is unnecessary at this stage. The ESAs will conduct a new monitoring exercise if and when market developments and risks merit the work.

The report is available at: <https://esas-joint-committee.europa.eu/Publications/Reports/JC 2018 29 - JC Report on automation in financial advice.pdf>.

MiFID II

European Commission Communication on Proposed Amendments to Technical Standards on Systematic Internalisers' Quote Rules

On September 3, 2018, the European Commission published a Communication (dated August 10, 2018) on proposed amendments by ESMA to a RTS, known as "RTS 1," supplementing the Markets in Financial Instruments Regulation.

Under MiFIR, Systematic Internalisers must make public firm quotes in equity instruments. The quotes must: (i) be at least equivalent of 10% of the standard market size for the quoted instrument; (ii) include both a bid and offer price; and (iii) reflect the prevailing market conditions for that instrument. RTS 1 specifies the concept of "prices reflecting prevailing market conditions" as being "close in price, at the time of publication, to quotes of equivalent sizes for the same financial instrument on the most relevant market in terms of liquidity." ESMA

submitted final draft amendments to RTS 1 in March 2018, which provided that, where a financial instrument is subject to the "minimum tick size" regime, the quotes of an SI can only adequately reflect prevailing market conditions when those quotes reflect the minimum price increments ("tick sizes") quoted by EU trading venues trading the instrument.

In the Communication, the European Commission states that it will endorse the proposed amended RTS1 once ESMA has made certain changes to the draft text to reflect the following concerns:

- I. when MiFIR was developed, the co-legislators did not provide that quotes of SIs would need to respect tick size increments, which means that technical standards cannot be used to address this point;
- II. there is evidence that not applying tick sizes to shares and depositary receipts risks negative repercussions on the liquidity in those two asset classes;
- III. quoting prices outside the tick size increments might also hinder the efficient valuation and pricing of shares and depositary receipts; and
- IV. the proposed amendments should be confined to shares and depositary receipts so that concerns about efficient price formation can be addressed while remaining in line with the legislative intent not to introduce a general obligation that all quotes by SIs have to respect the tick size increments.

A draft letter to ESMA from the Commission is attached as an annex to the Communication. The text of the proposed amendments has not been published.

The Communication is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-5369-F1-EN-MAIN-PART-1.PDF>, the draft letter to ESMA is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-5369-F1-EN-ANNEX-1-PART-1.PDF> and details of ESMA's final draft amendments to RTS1 are available at: <https://finreg.shearman.com/final-draft-eu-technical-standards-amending-syste>.

People

UK Financial Conduct Authority Appoints New Director of Competition

On September 5, 2018, the U.K. FCA issued a press release announcing the appointment of Sheldon Mills as its new director of competition. Mr. Mills is currently senior director, mergers and state aid at the Competition and Markets Authority. Mr. Mills will take up his role in November 2018.

The FCA press release is available at: <https://www.fca.org.uk/news/press-releases/fca-appoints-new-director-competition>.

Upcoming Events

September 27-28, 2018: Annual ESRB conference

October 3, 2018: EBA public hearing on the revised ITS for supervisory reporting under the Capital Requirements Regulation

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

October 10, 2018: EBA public hearing on the revised ITS on supervisory reporting in line with the Liquidity Coverage Requirement under the Capital Requirements Regulation

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

Upcoming Consultation Deadlines

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 17, 2018: U.K. BEIS consultation on a draft Bill introducing a register of the beneficial owners for overseas legal entities that own U.K. property

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

September 21, 2018: FCA interim report (MS 17/1.2) on its investment platform market study

September 21, 2018: FSB consultation on implementation of the LEI

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

September 26, 2018: ESMA consultation on revised Guidelines for periodic reporting by credit rating agencies

September 27, 2018: CPMI and IOSCO consultation on governance arrangements for OTC derivatives data elements

September 28, 2018: FCA call for input on the PRIIPs Regulation

September 30, 2018: BoE consultation on term SONIA reference rates

October 1, 2018: Comment deadline for interim final rule regarding the treatment of certain municipal obligations as high-quality liquid assets under the liquidity coverage ratio rule

October 5, 2018: ESMA consultation on minimum information content of exempted documents under the Prospectus Regulation

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 5, 2018: Law Commission consultation on reform of the anti-money laundering regime for England and Wales

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

October 14, 2018: Regulators (globally) consultation on a Global Financial Innovation Network

October 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)

October 26, 2018 – EBA consultation on revised ITS on supervisory reporting in line with the Liquidity Coverage Requirement under the Capital Requirements Regulation

October 27, 2018: FCA consultation on proposed changes to the rules governing P2P platforms

October 29, 2018: Comment deadline for interim final rule regarding expanded 18-month examination cycle for certain small insured depository institutions and U.S. branches and agencies of foreign banks

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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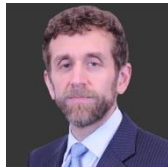
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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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