

## Financial Regulatory Developments Focus



### In this issue:

Derivatives  
Bank Prudential  
Regulation &  
Regulatory Capital  
Recovery & Resolution  
Financial Services  
Funds  
People

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

### Derivatives

#### ISDA Resolution Stay Protocol Announced

On October 11, 2014, the International Swaps and Derivatives Association (“ISDA”) announced that 18 banks have agreed to sign the new ISDA Resolution Stay Protocol. The Protocol, which will take effect from January 1, 2015, will impose a stay on cross-default and early termination rights in standard ISDA derivatives contracts between any of the 18 firms if one of them is subject to resolution. The press release states that regulators have committed to developing new regulations in their jurisdictions in 2015 that will promote broader adoption of the stay provisions beyond the 18 banks, a commitment that is also being pushed by the Financial Stability Board. Coverage will also be expanded, by regulations, to include US financial holding companies. The 18 banks that have signed up to the ISDA Resolution Stay Protocol are Bank of America Merrill Lynch, Bank of Tokyo-Mitsubishi UFJ, Barclays, BNP Paribas, Citigroup, Credit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan Chase, Mizuho Financial Group, Morgan Stanley, Nomura, Royal Bank of Scotland, Societe General, Sumitomo Mitsui Financial Group and UBS.

The ISDA announcement is available at: <http://www2.isda.org/news/major-banks-agree-to-sign-isda-resolution-stay-protocol>.

### Bank Prudential Regulation & Regulatory Capital

#### Federal Reserve Board Issues Guidance Regarding Competitive Review Process for Bank Acquisitions, Mergers and Other Transactions

On October 9, 2014, the Federal Reserve Board issued answers to frequently asked questions (“FAQs”) regarding the competitive review process for bank acquisitions, mergers and other transactions. The FAQs, developed jointly with the US Department of Justice, provide answers to questions raised by banking

organizations on filing applications in connection with bank acquisitions and mergers and also covers factors considered by the Federal Reserve Board and the US Department of Justice when conducting competitive analysis for bank applications.

The FAQs are available at:

<http://www.federalreserve.gov/bankinfo/competitive-effects-mergers-acquisitions-faqs.htm>.

### **Basel Committee Review of Sound Management of Operational Risk**

On October 6, 2014, the Basel Committee on Banking Supervision (the “Basel Committee”) published a review on the implementation of its principles for the sound management of operational risk, as well as a consultation paper dealing with revisions to the simpler approaches related to operational risk. The Basel Committee review found that banks have not made sufficient progress at implementing the Basel Committee principles and that they should, amongst other things, improve the implementation of these principles, as well as board and senior management oversight.

The Basel Committee is concerned that the operational risk capital requirements of a wide spectrum of banks is not correctly estimated and that weaknesses in the existing set of simple approaches to operational risk stem mainly from the use of gross income (“GI”) as a proxy indicator for operational risk exposure based on an often incorrect assumption that the operational risk exposure of banks increases linearly in proportion to revenue. The Basel Committee seeks feedback on proposals to: (i) replace GI with the business indicator (“BI”) for determining operational risk capital; (ii) remove differentiation by business-line as this is not found to be a significant risk-driver; and (iii) integrate size into the new methodology, as this is deemed to be a significant risk-driver. The consultation closes on January 6, 2015.

The review on sound management of operational risk is available at:

<http://www.bis.org/publ/bcbs292.pdf> and the consultation paper is available at <http://www.bis.org/publ/bcbs291.pdf>.

### **EBA Issues Report on Monitoring of AT1 Capital Instruments of EU Institutions**

On October 7, 2014, the European Banking Authority (“EBA”) issued a report on the monitoring of Additional Tier 1 (“AT1”) capital instruments of EU firms. Under the Capital Requirements Regulation (“CRR”), the EBA must monitor the quality of own funds instruments issued by firms across the European Union. Eligibility criteria for AT1 instruments are laid down in the CRR and are supplemented further with regulatory technical standards on own funds. A number of AT1 instruments have now been issued by EU institutions, and the EBA has assessed the terms and conditions of some of these issuances against the relevant regulatory provisions and requirements. The report states that for future issuances, some existing clauses should be revised, some clauses currently under

consideration should be avoided and that there are a number of areas that require further guidance to ensure that a common interpretation of the CRR provisions is applied.

The report is not intended to be fully comprehensive and is available at:

<http://www.eba.europa.eu/documents/10180/534414/report+AT1.pdf>.

### **Date for Publication of Results of EU-Wide Stress Test and Comprehensive Assessment Announced**

On October 10, 2014, the EBA announced that it will publish the results for the EU-wide stress test for the banking sector on October 26, 2014. The European Central Bank ("ECB") simultaneously announced that it will publish the results of the comprehensive assessment on the same date. The aim of the EU-wide stress test is to assess the resilience of EU banks to adverse market conditions as well as evaluate how systemic risks might increase in stress situations. The 2014 EU-wide stress test forms part of the ECB's comprehensive assessment. The ECB will assume new banking supervision responsibilities from November 4, 2014 under the Single Supervisory Mechanism and will directly supervise the largest Eurozone banks.

The EBA press release is available at: <http://www.eba.europa.eu/-/eba-announces-2014-eu-wide-stress-test-publication-date> and the ECB announcement is available at: <http://www.ecb.europa.eu/press/pr/date/2014/html/pr141010.en.html>.

### **Bank of England Announces Timings for Results of UK Stress Test for Eight Major Banks**

On October 10, 2014, the Bank of England announced that it was in the process of analyzing the information submitted by banks and credit unions for their stress tests. The Financial Policy Committee and Prudential Regulation Authority will be meeting on December 15, 2014 to make any final decisions on the results of the stress test and will provide details to the financial institutions involved on the same day. The UK stress test results will then be published together with the Financial Stability Report on December 16, 2014.

The announcement is available at:

<http://www.bankofengland.co.uk/publications/Pages/news/2014/126.aspx>.

## **Recovery & Resolution**

### **US and UK Authorities Discuss Resolution Issues for G-SIBs**

On October 13, 2014, HM Treasury published a press release confirming that the heads of US and UK Treasuries and financial regulatory bodies had met to discuss cooperation and information sharing in the event of the failure and resolution of a global systemically important bank ("G-SIB"). The meeting sought further understanding about the resolution regimes in the US and UK, in particular which aspects would require coordination between the regulators as well as any obstacles that there might be to resolution.

The press release is available at: <https://www.gov.uk/government/news/us-and-uk-officials-meet-to-discuss-key-components-for-the-resolution-of-a-global-systemically-important-bank>.

## Financial Services

### SEC Staff Issue Guidance on Customer Sales of Securities

On October 9, 2014, the Securities and Exchange Commission (“SEC”) announced the publication of a Risk Alert and FAQs reminding broker-dealers of their obligations when engaging in unregistered transactions on behalf of customers. The guidance was accompanied by the announcement of an enforcement action against two firms for improperly selling billions of shares of penny stocks through unregistered offerings on behalf of customers. The SEC Risk Alert outlines deficiencies discovered by the SEC’s Office of Compliance Inspections and Examinations in the course of a sweep of 22 broker-dealers frequently involved in the sale of microcap securities. Among the deficiencies discovered in the sweep, the SEC highlighted: (i) insufficient policies and procedures to monitor for and identify potential red flags in customer-initiated sales; (ii) inadequate controls to evaluate how customers acquired the securities and whether they could be lawfully resold without registration; and (iii) failure to file suspicious activity reports as required by the Bank Secrecy Act when encountering unusual or suspicious activity in connection with customers’ sales of microcap securities. Along with the Risk Alert, the SEC published FAQs to remind broker-dealers of the requirements for complying with the registration exemption for broker-dealers executing customers’ unregistered sale of securities as provided in Section 4(a)(4) of the Securities Act of 1933.

The SEC Risk Alert is available at: <http://www.sec.gov/about/offices/ocie/broker-dealer-controls-microcap-securities.pdf> and the SEC FAQs are available at: <http://www.sec.gov/divisions/marketreg/faq-broker-dealer-duty-section4.htm>.

### Technical Advice under CSDR Confirmed for June 2015

On October 6, 2014, the European Securities and Markets Authority (“ESMA”) published a letter (dated October 2, 2014) from the European Commission which confirms that the technical advice that ESMA is responsible for preparing under the Central Securities Depositories Regulation (the “CSDR”) is due on June 18, 2015. The letter confirms the mandates that the Commission sent to ESMA in June 2014, before the CSDR came into force on August 28, 2014.

### Basel Committee Seeks to Revise Corporate Governance Principles for Banks

On October 10, 2014, the Basel Committee launched a consultation on revised corporate governance principles for banks. The proposed revised principles aim to enhance the principles developed in 2010 which were developed in response to lessons learnt from the recent financial crisis. Although a peer review conducted by the Financial Stability Board earlier in 2014 found that both banks and

regulators had made good progress in improving corporate governance in banks, the review found that more work could be done to establish effective risk governance frameworks. As a result, the Basel Committee has decided to update its principles. The proposed revised principles seek to: (i) strengthen the guidance on risk governance; (ii) expand the guidance on the role of the board in overseeing implementation of effective management systems; (iii) emphasize the importance of the board's collective competence; and (iv) provide guidance for bank supervisors on the evaluation system used by banks to select board members and senior management. Responses to the consultation are due by January 9, 2015.

The consultation paper is available at: <http://www.bis.org/publ/bcbs294.pdf>.

## Funds

### IOSCO Proposes Revised Guidance on Custody Arrangements for CIS

On October 10, 2014, the International Organization of Securities Commissions published a consultation paper on proposals to update and revise its 1996 Guidance on Custody Arrangements for Collective Investment Schemes. The objective of the proposals is to take into account market developments and take a closer look at the custody and protection of assets since the failure of Lehman Brothers and MF Global and the Madoff fraud. The consultation is open until December 10, 2014.

The consultation paper is available at:

<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD454.pdf>.

## People

Dame Colette Bowe has been appointed as Chairman of the UK Banking Standards Review Council, taking over from the interim Chairman, Sir Richard Lambert, who led the review into setting up the new body.

The Federal Reserve Board has appointed William English as adviser to the Board for Monetary Policy in the Office of Board Members.

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.

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