



Financial Regulatory Developments Focus

In this week’s newsletter, we provide a snapshot of the principal US, 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 Financial Stability Oversight Council Releases Guidance Regarding Calculations of Stage 1 Threshold

On June 8, 2015, US Financial Stability Oversight Council staff released guidance providing additional information regarding the calculation of Stage 1 thresholds, used by the FSOC to help identify nonbank financial companies for potential supervision by the Board of Governors of the Federal Reserve System and to determine application of enhanced prudential standards to such companies. To assist its determination, the FSOC created a three-stage process, where it applies in Stage 1 six quantitative thresholds to a broad group of nonbank financial companies to assess whether any may be subject to further evaluation in Stage 2. The recent FSOC guidance describes the components of each of the thresholds, applicable accounting standards that are applied, data sources that are utilized, entities included in the calculations, the frequency of calculations and periodic review of the Stage 1 thresholds.

The FSOC staff guidance is available at:

<http://www.treasury.gov/initiatives/fsoc/designations/Documents/FSOC%20Staff%20Guidance%20-%20Stage%201%20Thresholds.pdf>.

US Federal Agencies Issue Final Standards for Assessing Diversity Policies and Practices of Regulated Entities

On June 9, 2015, several US federal financial regulatory agencies (including the Board of Governors of the Federal Reserve System, the Consumer Financial Protection Bureau, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency and the Securities and Exchange Commission) issued a final interagency policy statement creating joint standards to assess the diversity policies and practices of entities they regulate, as required by Section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Similar to the proposed standards, the final standards provide regulated entities with a framework for strengthening their diversity policies and practices. This framework includes an organizational commitment to diversity, workforce and employment practices, procurement and business practices and practices to promote transparency of organizational diversity and inclusion within the entities' US operations.

The final interagency policy statement is effective on publication in the Federal Register.

The press release is available at: <http://www.federalreserve.gov/newsevents/press/bcreg/20150609a.htm> and the interagency policy statement is available at: <https://www.federalregister.gov/articles/2015/06/10/2015-14126/final-interagency-policy-statement-establishing-joint-standards-for-assessing-the-diversity-policies>.

US Federal Agencies Publish Volcker Rule Frequently Asked Questions 14 and 15

On June 12, 2015, the US federal agencies responsible for implementing the Volcker Rule (the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission) issued two new Volcker Rule Frequently Asked Questions. The FAQs provide guidance regarding the application of covered funds exclusions to foreign public funds and joint ventures.

FAQ 14 generally provides that foreign public funds sponsored by banking entities will not themselves be treated as banking entities even if controlled by a foreign banking entity though means other than share ownership. FAQ 15 generally emphasizes that joint ventures must be engaged in business activities, as opposed to investing in securities or other financial instruments, in order to be exempt as a joint venture.

FAQ 14 is available at: <http://www.federalreserve.gov/bankinfo/volcker-rule/faq.htm#14> and FAQ 15 is available at: <http://www.federalreserve.gov/bankinfo/volcker-rule/faq.htm#15>.

Consumer Protection

US Consumer Financial Protection Bureau To Supervise Nonbank Auto Finance Industry

On June 10, 2015, the US Consumer Financial Protection Bureau published a rule that for the first time permits CFPB oversight over larger non-bank auto finance companies. The agency's Supervisory and Examination Manual has also been updated to guide examiners who are monitoring compliance by auto finance companies with federal consumer financial laws (e.g., the Equal Credit Opportunity Act, the Truth in Lending Act, the Consumer Leasing Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act's prohibition on unfair, deceptive or abusive acts or practices).

The final rule extends the CFPB's current oversight of auto financing at the largest banks and credit unions to any nonbank auto finance company that makes, acquires or refinances 10,000 or more loans or leases in a year. The final rule also defines additional automobile leasing activities for coverage by certain consumer protections of the Dodd-Frank Act. While the CFPB has finalized the rule largely as proposed in September 2014, the final rule broadens the category of transactions involving asset-backed securities that are not counted toward the 10,000 transaction threshold and slightly modifies the definition of refinancing for the purpose of the threshold.

The CFPB rule will take effect 60 days after publication in the Federal Register.

The CFPB press release is available at: <http://www.consumerfinance.gov/newsroom/cfpb-to-oversee-nonbank-auto-finance-companies/>.

The final rule is available at: http://files.consumerfinance.gov/f/201506_cfpb_defining-larger-participants-of-the-automobile-financing-market-and-defining-certain-automobile-leasing-activity-as-a-financial-product-or-service.pdf and the Examination Procedures for Auto Finance are available at: http://files.consumerfinance.gov/f/201506_cfpb_automobile-finance-examination-procedures.pdf.

Derivatives

US Commodity Futures Trading Commission's Division of Market Oversight Extends Time-Limited, No-Action Relief for Swap Dealers and Major Swap Participants from Compliance with Reporting Obligations

On June 5, 2015, the US Commodity Futures Trading Commission's Division of Market Oversight issued a no-action letter (CFTC Staff Letter 15-38) extending time-limited relief to Swap Dealers and Major Swap Participants from the obligation to report valuation data for cleared swaps. The no-action relief applies to (i) all SDs and MSPs that are reporting counterparties under regulation 45.8, for the purposes of section 45.4(b)(2)(ii) of the CFTC's regulations, and (ii) all cleared swaps for which the SD or MSP has the obligation to report valuation data under section 45.4(b)(2)(ii). According to the no-action letter, the DMO will not recommend that the CFTC take enforcement action against an SD or MSP for failing to comply with the requirements of the CFTC's regulation to report valuation data.

Originally expiring on June 30, 2015, in accordance with the time-limited relief provided previously in CFTC Staff Letter 14-90, the no-action letter issued on June 15, 2015, extends the relief until June 30, 2016.

The press release is available at: <http://www.cftc.gov/PressRoom/PressReleases/pr7186-15#PrRoWMBL>.

CFTC Staff Letter 15-38 is available at: <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/15-38.pdf> and CFTC Staff Letter 14-90 is available at: <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/14-90.pdf>.

European Supervisory Authorities Consult Again on Margin for Uncleared Derivatives

On June 10, 2015, the European Supervisory Authorities published their second consultation on draft regulatory technical standards on risk mitigation techniques for OTC derivatives not cleared by a CCP. Under the European Market

Infrastructure Regulation, counterparties to uncleared OTC derivative transactions are required to implement risk mitigation techniques to reduce counterparty credit risk. The draft RTS cover the regulatory amount of initial and variation margin to be posted and collected, the collateral eligible for exchange of margins, operational procedures, a procedure for intragroup exemptions to be granted and provisions for the specific treatment of certain products, such as physically settled FX swaps. This second consultation follows the proposals published in April 2014 which were extensively commented upon and seek to address the issue of how the requirements would impact firms subject to differing requirements across jurisdictions.

The second consultation seeks feedback on a narrower set of issues, including: (i) the treatment of non-financial counterparties established outside of the EU; (ii) the timing of calculation, call and delivery of initial and variation margin; (iii) whether any unintended consequences might arise due to the design or implementation of initial margin models; (iv) the requirements for trading relationship documentation; (v) the treatment of FX mismatch between collateral and OTC derivatives; (vi) whether allowing cash posted as initial margin to be re-invested will alleviate concerns that the ban on rehypothecation would result in a de facto ban of cash as initial margin; (vii) whether replacing the requirement to obtain legal opinions regarding the segregation of initial margin with a requirement for counterparties to conduct an internal assessment of the reliability and enforceability of agreements in each jurisdiction is sufficient to ease the burden on counterparties; and (viii) the revised regime for units in UCITS as eligible collateral. Responses to the consultation are due by July 10, 2015. The ESA's propose to follow the revised international timeline adopted in March this year for implementation of the framework, proposing that the requirements enter into force on September 1, 2016 with margin requirements being phased in from that date until September 1, 2020.

The consultation paper is available at: <http://www.esa.europa.eu/documents/10180/1106136/JC-CP-2015-002+JC+CP+on+Risk+Management+Techniques+for+OTC+derivatives+.pdf>.

Financial Market Infrastructure

Assessment Report on Implementation of the Principles for Financial Market Infrastructures

On June 11, 2015, the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions published the second report on Level 1 assessments of implementation monitoring of the Principles for Financial Market Infrastructures. Level 1 assessments are based on self-assessments by individual jurisdictions on how they have adopted the PFMI through legislation, regulations and other policies. The PFMI are international standards for payment, clearing and settlement systems and trade repositories aimed at ensuring that such infrastructure is robust and able to withstand financial stability shocks. Level 1 assessments will next be undertaken in 2016.

The report is available at: <http://www.bis.org/cpmi/publ/d129.pdf>.

Financial Services

US Securities and Exchange Commission Publishes Request for Public Comment on Exchange-Traded Products

On June 12, 2015, the US Securities and Exchange Commission announced that it is seeking public comment on the listing and trading of new, novel or complex exchange-traded products ("ETPs"). Specifically, the request deals with key issues that arise when market participants seek an exemption in order to trade a new ETP or when a securities exchange is looking to establish standards for the listing of new ETPs.

ETPs have become an important investment vehicle to market participants. Given the significant increase in the number and complexity of new products, the SEC has determined that broad public input is necessary regarding certain issues, including arbitrage mechanisms and market pricing for ETPs, legal exemptions and other regulatory positions related to

the trading of ETPs and securities exchange listing standards for ETPs. The request also solicits comment on how market professionals sell ETPs, especially to retail investors, and on investors' understanding of the nature and use of ETPs. The public comment period will remain open for 60 days following publication of the comment request in the Federal Register.

The press release is available at: <http://www.sec.gov/news/pressrelease/2015-118.html> and the request for comment is available at: <http://www.sec.gov/rules/other/2015/34-75165.pdf>.

UK Fair and Effective Markets Review Makes Recommendations in Final Report

On June 10, 2015, the final report of the UK Fair and Effective Markets Review was published. The report includes an analysis of the causes of recent misconduct in the Fixed Income, Currency and Commodities markets, an evaluation of the impact of related reforms that have been implemented or are otherwise in progress and recommendations to enhance the fairness of the FICC markets. The recommendations will need to be implemented by public authorities and market participants domestically although several will require international discussions and coordination to implement. The recommendations to be implemented domestically include: (i) extending the UK criminal sanctions regime for market abuse by including a wider range of FICC markets, lengthening the maximum sentence from seven to ten year's imprisonment and creating a regime for spot FX (the latter would be a civil and criminal regime for market abuse); (ii) extending certain elements of the Senior Managers and Certification regimes to a wider range of regulated firms that participate in the FICC markets; (iii) establishing a new FICC Market Standards Board; (iv) improving awareness of the application of competition law to the FICC markets; (v) developing new training and qualification standards; (vi) and requiring regulatory references for individuals. Recommendations requiring international coordination include: (i) developing globally agreed common standards for trading practices in FICC markets; (ii) agreeing a single global FX code; (iii) considering how to ensure benchmark administrators publish consistent self-assessments; and (iv) examining means to improve the alignment of remuneration and conduct risk. A report on implementation progress will be published by June 2016.

The final report is available at: <http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf>.

Bank of England Announces Open Forum on Assessment of the Reforms Impacting the FICC Markets

On June 11, 2015, the Bank of England announced an Open Forum, that will take place in autumn this year, to assess the financial regulatory reforms affecting the FICC markets that are already implemented or in train. Alongside the announcement, the Bank published a paper detailing its analysis of the short failings of the FICC market, issues with its own frameworks and operating procedures, measures to rectify those failings and the difficulties that remain. Further details of the Open Forum will be published in due course. In the meantime, stakeholders are invited to register their interest in attending the event through the Bank of England's website.

The announcement is available at: <http://www.bankofengland.co.uk/markets/Pages/openforum.aspx> and the related document is available at: <http://www.bankofengland.co.uk/markets/Documents/openforum.pdf>.

Final UK Rules on Restrictions on Retail Distribution of CoCos and Mutual Society Shares

On June 12, 2015, the Financial Conduct Authority published its Policy Statement and final rules on the restrictions on the retail distribution of contingent convertible securities, known as CoCos, and mutual society shares. The FCA announced a temporary ban on the retail distribution of CoCos, which entered into force on October 1, 2014. The final permanent rules restricting distribution of CoCos to retail clients will come into effect on October 1, 2015 and the rules on mutual society shares will come into effect on July 1, 2015.

The FCA's Policy Statement is available at: <http://www.fca.org.uk/static/documents/policy-statements/ps15-14.pdf>.

Recovery & Resolution

European Banking Authority's Technical Advice on Target Level and Initial Period for Contributions to the Single Resolution Fund

On June 10, 2015, the EBA published technical advice on the target level and initial period for contributions to the Single Resolution Fund under the Single Resolution Mechanism. The EBA's advice was requested by the European Commission to assist it in developing legislation which specifies criteria for: (i) the spreading out in time of the contributions to the SRF; (ii) determining the number of years by which the initial period for reaching the target level can be extended; and (iii) establishing the annual contribution when the available financial means of the SRF falls below its target level after the initial period. The SRM and the SRF provide for the resolution of credit institutions and certain investment firms established in Member States within the Eurozone or in Member States that participate in the Banking Union. The SRF will support resolution measures for those banks and investment firms and will be financed by bank levies raised at national level. Ex ante contributions by those firms must be made to ensure that the SRF reaches a level of one per cent of the protected deposits of all banks within the Banking Union within eight years. The SRM and SRF are due to come into effect from January 1, 2016.

The EBA's advice is available at: <http://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-11+Technical+Advice+on+Art+69.pdf>.

Upcoming Events

June 17, 2015: US House of Representatives Committee on Financial Services public hearing entitled "The Annual Report of the Financial Stability Oversight Council."

June 17 and 18, 2015: IOSCO Annual Conference.

June 18, 2015: EBA public hearing on EMIR - risk mitigation techniques for non-centrally cleared OTC derivatives.

July 2, 2015: EBA public hearing on methodologies for the valuation of derivative liabilities.

July 3, 2015: EBA workshop on proportionality measures for regulatory purposes.

July 6, 2015: EBA public hearing on assigning risk weights to specialized lending exposures.

July 16 and 29, 2015: SEC outreach programs to aid firms in compliance with Regulation Systems Compliance and Integrity.

July 22, 2015: FCA Annual Public Meeting 2015.

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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