SHEARMAN & STERLING LLP

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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.

The quarterly European Governance & Securities Law Focus newsletter is available here.

Click here to access our website on Financial Regulatory Developments.

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Bank Prudential Regulation & Regulatory Capital

US Board of Governors of the Federal Reserve System Issues Guidance on Examinations of Insured Depository Institutions Prior to Membership as, or Merger Resulting in, a State Member Bank

On October 13, 2015, the US Board of Governors of the Federal Reserve System issued guidance intended to clarify the criteria and process used by the Federal Reserve Board in determining whether to waive or to conduct pre-membership safety-and-soundness and consumer compliance examinations of insured depository institutions that are looking to either: (i) become state chartered member banks of the Federal Reserve System; or (ii) merge with another institution where a state member bank would be the surviving entity, including those with $10 billion or less in total consolidated assets. Specifically, the Federal Reserve Board stated that a state nonmember bank, national bank, or savings association seeking to convert its status to a state member bank will not generally be required to complete a safety-and-soundness or consumer compliance examination prior to the conversion if the institution seeking membership meets the criteria for "eligible bank," as set forth in the Federal Reserve Board's Regulation H, together with certain additional safety and soundness criteria set forth in the guidance (collectively, the "eligibility criteria"). Under circumstances where an insured depository institution is looking to merge with another institution where a state member bank would be the surviving entity, a safety-and-soundness or consumer compliance examination of the insured depository institution will not be required so long as the state member bank meets all of the eligibility criteria on an existing and pro-forma basis.

The guidance is available at: http://www.federalreserve.gov/bankinforeg/srletters/SR1511.htm.

UK Regulator Consults on Identifying Other Systemically Important Institutions

On October 19, 2015, the Prudential Regulation Authority launched a consultation on its proposed criteria and methodology for identifying Other Systemically Important Institutions, i.e. institutions that are not classed as globally systematically important financial institutions but whose failure would have a significant negative effect on the UK financial system. According to the Capital Requirements Directive, national regulators are required to identify O-SIIs that are banks, investment firms or mixed financial holding companies incorporated in their jurisdiction. That requirement derives from the Basel Committee on Banking Standards framework for domestic systemically important banks or D-SIBs. In developing its proposals, the PRA states that it has to take into account the relevant EBA Guidelines on the assessment of O-SIIs. The PRA must identify as O-SIIs those firms whose distress or failure would have a systemic impact on the UK or EU economy or financial system due to size, importance, complexity, cross-border activity and interconnectedness. Firms that are designated as O-SIIs by the PRA will be subject to enhanced supervision by the PRA. However, the PRA considers that O-SIIs are likely to be those firms that are currently subject to PRA supervision as a Category 1 firm and therefore there will be minimal impact on the firms. The PRA intends to publish the first list of O-SIIs in Q1 2016 and thereafter annually by December 1, each year. The consultation is open until January 18, 2016. The PRA will publish its final Statement of Policy in Q1 2016.

The consultation paper is available at:
http://www.bankofengland.co.uk/pra/Documents/publications/cp/2015/cp3915.pdf.

Bank Structural Reform

UK Regulator Consults on Implementation of Ring-Fencing for Core UK Financial Services and Activities

On October 15, 2015, the PRA published a consultation paper on the implementation of ring-fencing for core UK financial services and activities, as required under the Financial Services and Markets Act 2000. Core activities are defined as: (i) facilities for accepting deposits or other payments into an account and provided in the course of carrying on the core activity of accepting deposits; (ii) facilities for withdrawing money or making payments from such an account; and (iii) overdraft facilities in connection with such an account. In this consultation, the PRA sets out new proposals for ring-fencing policies, including on: (i) prudential requirements for subsidiaries of Ring-Fenced Bodies;

(ii) prudential requirements for other potential affiliates that would not necessarily be regulated by the PRA; (iii) the application of the systemic risk buffer for RFBs; (iv) intragroup prudential arrangements for groups containing RFBs and proposals on concessions, distributions, double leverage and intragroup holdings of capital; and (v) the use of financial market infrastructures including inter-bank payment systems, Central Securities Depositories and CCPs. The proposals are relevant to all firms that are required to ring-fence their core activities before the implementation date of January 1, 2019 (which are firms, broadly speaking, with at least £25 billion of core deposits). The proposals are also relevant to growing firms that expect to meet this threshold by 2019. The PRA expects firms that currently meet the core deposits threshold of £25 billion to submit near-final plans to their PRA and Financial Conduct Authority supervisors, taking into consideration the proposals in this consultation paper, by January 29, 2016. Growing firms expecting to meet this threshold by 2019 must determine whether such a submission would be appropriate for them by consulting with their supervisors. The PRA intends to publish a policy statement, final rules and supervisory statements by mid-2016 setting out the feedback to this consultation. Comments on the consultation paper are due by January 15, 2016.

The consultation is available at: http://www.bankofengland.co.uk/pra/Documents/publications/cp/2015/cp3715.pdf.

Consumer Protection

US Consumer Financial Protection Bureau Finalizes Amendments to Home Mortgage Disclosure Act Rule

On October 15, 2015, the US Consumer Financial Protection Bureau issued a final rule intended to streamline the process of reporting residential mortgage market information for financial institutions. Regulation C implements the Home Mortgage Disclosure Act and requires lenders to report certain information regarding home loans for which they receive applications or that they originate or purchase. The final rule amends current Regulation C requirements by calling for more specific information from lenders, such as property value, term of the loan, and the duration of any teaser or introductory interest rates. In addition, financial institutions will be obligated to deliver certain information about mortgage loan underwriting and pricing, such as an applicant's debt-to-income ratio, the interest rate of the loan, and the discount points charged for the loan. Aside from requiring lenders to report more detailed information, the final rule also attempts to simplify the reporting process by easing reporting requirements for some small banks and credit unions and aligning reporting requirements more closely with industry standards. The rule also provides guidance on compliance with both new and existing requirements under Regulation C.

The CFPB press release is available at:
http://www.consumerfinance.gov/newsroom/cfpb-finalizes-rule-to-improve-information-about-access-to-credit-in-the-mortgage-market/.

The final rule is available at:
http://files.consumerfinance.gov/f/201510_cfpb_final-rule_home-mortgage-disclosure_regulation-c.pdf.

Corporate Governance

UK Government Announces Amendments to and Extension of Senior Manager and Certification Regime

On October 15, 2015, HM Treasury announced that certain amendments would be made to the Senior Manager and Certification Regime and that the SM&CR would be extended to all UK authorized firms. Amendments include:
(i) removal of the presumption of responsibility for a senior manager when a breach of regulatory provisions occurs in the area in the firm that he is responsible for. The regulator will instead be responsible for proving that a senior manager did not take reasonable steps to prevent a breach from occurring or continuing; (ii) granting the regulators specific powers to take enforcement action against all non-executive directors of firms for their misconduct; and (iii) removing

the statutory obligation for firms to notify the regulators when a breach of the Rules of Conduct occurs. Instead, the regulators will be able to make rules providing for when any such notifications would be required. The extension of the SM&CR follows from the recommendations of the Fair and Effective Markets Review in June 2015 that the regime should be extended to wholesale participants in the fixed income, currency and commodity markets. Both the amendments and the extension will be effected through primary legislation in the form of the Bank of England and Financial Services Bill that has been laid before Parliament. However, secondary legislation will also be amended to ensure that the reverse burden of proof and the notification requirements for breach of regulatory rules do not come into effect when the SM&CR comes into effect, which will be on March 7, 2016. It is currently expected that the extension of the SM&CR to all other UK financial institutions will be implemented during 2018.

The announcement is available at:
https://www.gov.uk/government/news/chancellor-announces-bank-of-england-and-financial-services-bill.

The policy paper is available at:
https://www.gov.uk/government/publications/senior-managers-and-certification-regime-extension-to-all-fsma-authorised-persons.

Derivatives

US Commodity Futures Trading Commission Further Implements Trade Execution Requirement

On October 14, 2015, the US Commodity Futures Trading Commission's Division of Market Oversight extended existing time-limited no-action relief for swaps executed as part of certain package transactions that currently receive relief from the requirement that such swaps be executed on a Designated Contract Market or Swap Execution Facility under CFTC Letter 14-137, which was issued in November 2014. In the CFTC no-action letter, the CFTC found that requiring certain package transactions be executed on a SEF or DCM still presents challenges to both counterparties as well as to SEFs and DCMs. Because many of the challenges previously necessitating no-action relief for certain package transactions have still not yet been resolved, the CFTC is extending relief from the trade execution requirement to enable market participants to continue to execute certain package transactions in a flexible manner. In a statement issued concurrently with the no-action letter, CFTC Commissioner J. Christopher Giancarlo criticized this fourth extension of no-action relief, noting that the need for repeated extensions proves that the CFTC's efforts to force certain complex package transactions to trade via a SEF's limited execution methods is "simply not workable." In the statement, Commissioner Giancarlo expressed support instead for allowing SEFs flexibility to implement the execution methods currently used to trade package transactions in global markets.

The press release is available at: http://www.cftc.gov/PressRoom/PressReleases/pr7260-15.

CFTC Staff Letter 15-55 is available at:
http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/15-55.pdf.

The statement of Commissioner J. Christopher Giancarlo is available at:
http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement101415.

Funds

US Securities and Exchange Commission Publishes Private Funds Statistics Report

On October 16, 2015, the US Securities and Exchange Commission published a report of private fund industry statistics and trends. The SEC aggregated and anonymized data private fund advisors have submitted to the SEC on Form ADV and Form PF. The report, which the SEC intends to update periodically, reflects information reported from the first calendar quarter of 2013 through the fourth calendar quarter of 2014. Among other things, the report includes statistics

about the distribution of borrowings, an analysis of hedge fund gross notional exposure to net asset value, information regarding beneficial ownership and a comparison of average hedge fund investor and hedge fund portfolio liquidity.

The report is available at:
http://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2014-q4.pdf.

MiFID II

Corrigendum to Markets in Financial Instruments Regulation Published

On October 15, 2015, a corrigendum was published in the Official Journal of the European Union, correcting the date of entry into force of Article 4(6) of the Markets in Financial Instruments Regulation. Under Article 4(6), the European Securities and Markets Authority must develop Regulatory Technical Standards on national regulators' powers to waive the pre-trade transparency requirements under which market operators and investment firms operating a trading venue must make public information such as current bid and offer prices for shares, exchange-traded funds and other similar financial instruments traded on a trading venue. In particular, the RTS should specify, amongst other things, the range of bid and offer prices to be made public for each class of instrument, as well as the depth of trading interest at those prices and the negotiated transactions that do not contribute to price formation. This provision should have been applicable from the date MiFIR entered into force, July 2, 2014, however Article 55 did not include the cross-reference.

The corrigendum is available at:
http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2015.270.01.0004.01.ENG.

Recovery & Resolution

UK Regulator Consults on Ensuring Operational Continuity in Resolution

On October 15, 2015, the PRA published a consultation paper proposing the creation of a new framework that would require firms to ensure operational continuity of shared services that are considered critical to the economy. This would mean that in the event of failure of a firm, recovery action, resolution or post-resolution restructuring would be facilitated. This consultation is relevant to banks, building societies and PRA-authorized investment firms and follows the PRA's previous discussion paper on this topic, published in October 2014, which includes draft rules and a supervisory statement. The consultation paper does not define the size of firms that are intended to be in scope, but notes that those firms that are deemed to perform functions critical to the economy as well as ring-fenced bodies and global systemically important banks are likely to be included. Similarly, the EU Bank Recovery and Resolution Directive would also preserve critical functions of firms by allowing authorities to place them into resolution, and in light of this, the PRA is consulting on such proposals. The PRA aims to publish an addendum to the consultation which will define the scope of the requirements together with a BoE consultation on the calibration of the minimum requirement for own funds and eligible liabilities. The PRA invites respondents to provide comments on the proposals but notes that respondents may wish to wait for the publication of the addendum before doing so. The addendum will set the closing date for the consultation period.

The consultation is available at: http://www.bankofengland.co.uk/pra/Documents/publications/cp/2015/cp3815.pdf.

Upcoming Events

October 22, 2015: Federal Deposit Insurance Corporation open meeting on notice of final rulemaking to establish margin and capital requirements for covered swap entities and interim final rule to exempt commercial end users and small banks.

November 2, 2015: The Commodity Futures Trading Commission's Market Risk Advisory Committee will hold a public meeting.

November 3, 4, 5, 9 and 11, 2015: FCA workshop for Credit Unions: Senior Managers and Certification Regimes Improving Individual Accountability.

November 4, 2015: European Central Bank Forum on Banking Supervision (registration by invitation only).

November 11, 2015: BoE Open Forum.

November 13, 2015: European Banking Authority public hearing on the harmonized definition of default under the Capital Requirements Regulation.

November 18 and 19, 2015: EBA Fourth Annual Research Workshop: Financial regulation and the real economy: a micro prudential perspective.

Upcoming Consultation Deadlines

October 30, 2015: PRA and FCA Consultations on implementation of ring-fencing transfer schemes.

October 31, 2015: European Securities and Markets Authority Consultation on draft Implementing Technical Standards under MiFID II and MiFIR.

November 9, 2015: FCA Consultation on Part I of Implementation of UCITS V Directive.

December 7, 2015: FCA Consultation on Part III of Implementation of UCITS V Directive.

December 7, 2015: PRA and FCA Consultation on Regulatory References.

December 7, 2015: Committee on Payments and Market Infrastructures Consultation on Correspondent Banking Reforms.

December 22, 2015: FCA and HM Treasury Consultation on Public Financial Guidance.

December 22, 2015: FCA and HM Treasury Call for Input on Improving Access to Financial Advice for Consumers.

December 24, 2015: ESMA consultation on RTS for the European Single Electronic Format under the Transparency Directive.

January 6, 2016: European Commission Consultation on EU Covered Bond Framework.

January 6, 2016: European Commission Consultation on EU Venture Capital Investment Funds Regulation and European Social Entrepreneurships Funds Regulation.

January 15, 2016: PRA Consultation on Implementation of Ring-Fencing for Core UK Financial Services and Activities.

January 18, 2016: PRA Consultation on Identifying Other Systemically Important Institutions.

January 22, 2016: EBA Consultation on draft guidelines on application of definition of default under the CRR.

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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