SHEARMAN & STERLING LLP

FINANCIAL INSTITUTIONS ADVISORY & FINANCIAL REGULATORY GROUP NEWSLETTER

NOVEMBER 22, 2017

# Financial Regulatory Developments Focus

**In this 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.**

Click here if you wish to access our Financial Regulatory Developments website.

## In this Issue (please click on any title to go directly to the corresponding discussion):

## Bank Prudential Regulation & Regulatory Capital

### Federal Reserve Board Extends Comment Periods for Two Supervisory Proposals

On November 17, 2017, the US Board of Governors of the Federal Reserve System announced an extension of the comment period for two significant proposals that are currently out for comment. One proposal concerns guidance on supervisory expectations for boards of directors, and the other concerns a new large financial institution supervisory rating system. The comment period for both proposals had been previously extended through November 30, 2017, but will now remain open through February 15, 2018.

The Proposed Guidance on Supervisory Expectations for Boards of Directors is available at: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20171117a2.pdf.

The Proposed Large Financial Institution Rating System is available at: https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20171117a1.pdf.

### Bipartisan Support for Financial Regulatory Relief Bill

On November 16, 2017, Mike Crapo, chairman of the US Senate Committee on Banking, Housing, and Urban Affairs, introduced the Economic Growth, Regulatory Relief and Consumer Protection Act which would introduce significant financial regulatory reform. Among other things, the bill, which received bipartisan support, would reduce the threshold at which a bank holding company is considered to be a "systemically important financial institution" from $50 billion to $250 billion. The bill also provides other relief for community banks, including setting a leverage ratio of tangible equity to average consolidated assets of between 8% and 10% for banks with less than $10 billion in assets. These same institutions would be exempt from the Volcker Rule. US Senator Sherrod Brown (ranking member of the US Senate Banking Committee) released a statement opposing the bill, cautioning generally against rolling back the protections of Dodd-Frank with little or no perceived benefit to working families. The full Senate Banking Committee is expected to mark up the bill after Thanksgiving.

The full text of the bill is available at: https://www.banking.senate.gov/public/_cache/files/96d07158-bf57-4f2e-9bfe-888db5dad6ab/7EC24EE731A96E317839101D6AE8FF34.sil17981.pdf.

### House Financial Services Committee Advances 23 Bills, Including Many Directed at Regulatory Reform

On November 15, 2017, the US House Financial Services Committee announced that it had approved 23 bills, many of which are focused on financial regulatory reform. In a press release, US House Financial Services Committee Chairman Jeb Hensarling noted that the bills are intended to provide greater capital market access to small business, and relief for community banks and credit units. The 23 bills include a proposed repeal of Title VIII of Dodd-Frank, which gives the Financial Stability Oversight Council the ability to designate payment and clearing organizations as financial market utilities and allows them to have access to the Federal Reserve discount window. Other bills included in the package would improve the living will submission process and stress testing process, including that a bank holding company would only be subject to the Federal Reserve Board's Comprehensive Capital Analysis and Review process every two years.

The full text of the bills are available on the House Financial Services Committee website: https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=402663.

### US Banking Regulators Discuss Lessons Learned Since the Financial Crisis

On November 15, 2017, Michael Held, Vice President and General Counsel of the Federal Reserve Bank of New York discussed the many lessons learned from the financial crisis and cautioned against the dangers of forgetting these lessons. Mr. Held conceded that although post-crisis reforms and regulations should be reviewed, they should not be repealed at the cost of safety and soundness. Mr. Held discussed the improved resilience of the financial system,

including praising the Orderly Liquidation Authority and other post-crisis improvements to the bankruptcy process, as improving cross-border resolution. Mr. Held stressed that financial institutions and regulators need to evolve as systems and risks evolve, in order to be adequately prepared for the next economic downturn.

A day prior, Martin J. Gruenberg, Chairman of the US Federal Deposit Insurance Corporation warned against repeating prior mistakes in the current economic and regulatory climate noting that despite economic prosperity, there is still an ever-present possibility of an economic shock. Chairman Gruenberg highlighted that the post-crisis financial reforms have been largely positive, and have fostered growth while also strengthening the safety and soundness of financial institutions. At the same time, Gruenberg conceded that much of the post-crisis regulations could benefit from comprehensive review and streamlining, but cautioned against eroding the protections that have been implemented.

The full text of Mr. Held's remarks are available at: https://www.newyorkfed.org/newsevents/speeches/2017/hel171115 and the full text of Chairman Gruenberg's remarks are available at: https://www.fdic.gov/news/news/speeches/spnov1417.html.

### European Banking Authority Publishes Methodology for 2018 EU-Wide Stress Test

On November 17, 2017, the European Banking Authority published the final methodology for the EU-wide stress test exercise for banks that will be launched in January 2018. The methodology is being published well ahead of the formal launch, to give banks time to prepare.

Banks will be required to stress a common set of risks, namely credit risk (including securitizations), market risk, counterparty credit risk and operational risk (including conduct risk). Banks will also be asked to project the effect of the scenarios on net interest income and to stress profit and loss and capital items not covered by other risk types. The methodology is similar to that published in 2016 but is adjusted to incorporate IFRS 9 accounting standards.

The objective of the stress test is to provide national regulators, banks and other market participants with a common analytical framework to consistently compare and assess the resilience of EU banks and the EU banking system to shocks, and to challenge the capital position of EU banks. It is also intended to inform the supervisory review and evaluation process (SREP) carried out by national regulators. The disclosure of granular data on a bank-by-bank level is meant to facilitate market discipline and also serves as a common ground on which national regulators base their assessments.

The results of the stress test exercise will be published by November 2, 2018.

The EBA Methodological Note is available at: http://www.eba.europa.eu/documents/10180/1869811/2018+EU-wide+stress+test+-+Methodological+Note.pdf?_sm_au_=iVVnrL26D6SHs2HV.

### European Central Bank Regulations and Decisions on Systemically Important Payment Systems Published

On November 16, 2017, two regulations and two decisions of the European Central Bank on systemically important payment systems were published in the Official Journal of the European Union and will enter into force on December 6, 2017. These regulations and decisions have been made by the ECB in its capacity as supervisor under the Single Supervisory Mechanism for Eurozone banks, following the first comprehensive assessment of SIPS.

The two regulations amend: (i) the ECB Regulation on oversight requirements for SIPS, to make clarifications and amendments deemed necessary for the application of the highest oversight standards; and (ii) the ECB Regulation on the powers of the ECB to impose sanctions, to ensure that sanctions can be effectively imposed for oversight infringements.

The two decisions cover procedural aspects for the ECB to impose corrective measures for non-compliance with the ECB Regulation on oversight requirements and the methodology for calculating sanctions when the oversight requirements are infringed.

The Regulation Amending the Regulation on Oversight Requirements is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R2094&from=EN, the Regulation Amending the Regulation on ECB Sanctions Powers is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017R2095&from=EN, the Decision on Procedural Aspects is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017D0033&from=EN and the Decision on Sanctions Calculation Methodology is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32017D0035&from=EN.

### European Banking Authority Reports Good Compliance with Its Guidelines for Identification of Other Systemically Important Institutions

On November 15, 2017, the EBA published a report setting out the outcomes of its ongoing peer review exercise into whether its 2014 Guidelines specifying the criteria for the identification of Other Systemically Important Institutions (O-SIIs) have been applied effectively. National regulators from the EU Member States and the supervisory authorities of the three countries of the European Economic Area participated in the peer review exercise. The EBA report concludes that the majority of national regulators are compliant, but notes deviations from the Guidelines in some jurisdictions.

O-SIIs are institutions that are not classed as globally systemically important financial institutions but whose failure would have a significant negative effect on the financial system, either at EU level or at the level of an EU Member State. Institutions identified as O-SIIs attract stricter regulatory requirements under the Capital Requirements Directive, in particular the "O-SII buffer" which focuses on reducing the institution's probability of default.

The EBA was mandated under the CRD to issue the Guidelines to promote consistent identification of O-SIIs. The Guidelines establish a minimum mandatory framework of criteria and indicators for identifying O-SIIs. This framework serves as the initial benchmark. National regulators are encouraged to complement the minimum framework with further optional criteria and indicators to reflect the specificities of each national banking sector. In its Report, the EBA highlights best practices that it has observed. However, it also notes different approaches taken by national regulators on how to maintain the O-SIIs' identification methodology up-to-date and meet disclosure requirements and considers that the notification and disclosure obligations would benefit from greater harmonization. The EBA recommends that the list of optional indicators included in the Guidelines should be expanded to align these indicators with national regulators' practices and requests. It also recommends improvements to the effectiveness and comprehensiveness of disclosure and notification requirements, by means of adjustments to the Guidelines and to the notification template.

The EBA also considers that it would be desirable if further guidance could be provided to reduce variation in the calibration and use of the O-SII buffer. However, it does not set out guidance for this, as it falls within the remit of European Commission work on the EU macro-prudential framework in the context of the revision to the CRD and the Capital Requirements Regulation.

The Final Peer Review Report is available at: http://www.eba.europa.eu/documents/10180/1720738/Final+Peer+review+Report+on+EBA+O-SIIs+Guidelines.pdf and the EBA Guidelines are available at: https://www.eba.europa.eu/documents/10180/930752/EBA-GL-2014-10+(Guidelines+on+O-SIIs+Assessment).pdf.

### European Banking Authority Issues Final Guidance on Identifying Connected Clients

On November 14, 2017, the EBA published final Guidelines on connected clients under the CRR, following two earlier consultations. The Guidelines are intended to replace the "Guidelines on the implementation of the revised large exposures regime" issued in 2009 by the EBA's predecessor, the Committee of European Banking Supervisors.

The concept of "connected clients" features widely in the CRR. The connections between clients, particularly relationships of control or economic dependencies, can mean that financial problems of one entity are, in effect, transferred via this interrelationship to another entity that otherwise would not be concerned. The objective of the Guidelines is to clarify the situations in which this type of interconnectedness should lead to the grouping of clients because they effectively constitute a single risk for the purposes of the CRR.

Guidelines are intended to apply to all areas of the CRR where the concept of connected clients is used, namely: the large exposures regime; the categorization of clients in the retail exposure class for the purposes of credit risk; the development and application of rating systems; the specification of items requiring stable funding for reporting purposes; and the small- and medium-sized enterprise (SME) supporting factor. The Guidelines also apply to EBA technical standards and EBA guidelines that refer to "groups of connected clients" in the context of liquidity reporting and the reporting of concentration of funding and concentration of counterbalancing capacity.

The Guidelines are consistent with the standards on the supervisory framework for measuring and controlling large exposures issued by the Basel Committee on Banking Supervision in April 2014. However, they are more detailed and go further than the Basel standards by including additional guidance, such as on an alternative approach for exposures to central governments and on the relation between interconnectedness through control and economic dependency.

The Guidelines will apply from January 1, 2019.

The Final Guidelines are available at: http://www.eba.europa.eu/documents/10180/2025808/Final+Guidelines+on+connected+clients+%28EBA-GL-2017-15%29.pdf.

## Conduct & Culture

### UK Financial Conduct Authority Consults on Measures to Reduce Misconduct in Unregulated Markets and Activities

On November 3, 2017, the Financial Conduct Authority published a consultation paper on proposals to clarify its expectations on authorized firms and their staff when operating in markets or undertaking activities that are not covered by regulatory rules and principles. The FCA cites, as a particular example of the need to clarify its expectations, the spate of enforcement action in response to serious misconduct such as benchmark manipulation by employees of regulated firms in the fixed-income, currency and commodities (FICC) markets, which fall outside the FCA's regulatory perimeter.

A number of solutions to help reduce this type of misconduct in the FICC markets were suggested following the recommendations of the Fair and Effective Markets Review (FEMR) that was conducted in 2014–15. In these unregulated wholesale markets, activities undertaken by authorized firms were often only governed by industry-written codes of conduct, such as the UK's Non-Investment Products (NIPs) Code, rather than FCA rules. One recommendation of the FICC market standards board, which was established as a result of the FEMR, was that proper market conduct should be managed in FICC markets through regulators and firms monitoring compliance with all standards—formal and voluntary—under the Senior Managers and Certification Regimes.

The FCA believes there is a role for firms and their Senior Managers to champion the setting and achievement of higher standards. It sets out for consultation a general approach to supervising and enforcing the SM&CR rules for unregulated markets and activities, including those covered by industry-written codes of conduct.

It is also seeking views on a "recognition" approach for industry codes of conduct. Under the recognition approach, the FCA will review and assess industry codes against new criteria and then publicly state if it considers a particular code is a helpful explanation of the proper standard of market conduct for a particular market. The FCA considers that this will encourage participants to adhere to that code, but it does not intend that the recognition approach would give such codes a status equivalent to binding regulation. Instead, where recognized industry codes are complied with, the FCA will view this as tending to indicate compliance with FCA rules that require firms or individuals to observe "proper standards of market conduct" in relation to unregulated markets. The FCA will usually not take action against firms for behaviour that is so compliant.

The FCA also seeks views on extending the application of Principle 5 of its Principles for Businesses to unregulated activities. Principle 5 requires a firm to observe proper standards of market conduct, but currently only applies to regulated activities and ancillary unregulated activities. The FCA proposes to extend the application of Principle 5 to cover unregulated activities that are not ancillary to regulated activities.

Comments on the consultation and views on the extension of Principle 5 are invited by February 5, 2018. Comments must be submitted via an online response form.

The FCA Consultation Paper (CP 17/37) is available at: https://www.fca.org.uk/publication/consultation/cp17-37.pdf, the Online Response Form is available at: https://www.fca.org.uk/cp17-37-response-form and the Final Report of the Fair and Effective Markets Review is available at: http://www.bankofengland.co.uk/markets/Documents/femrjun15.pdf.

## Credit Ratings

### EU Authority Acts on New Third-Country Endorsement and Equivalence Regime for Credit Ratings

On November 17, 2017, the European Securities and Markets Authority published updated Guidelines on the application of the endorsement regime and Technical Advice on the equivalence of certain third-country legal and supervisory frameworks under the Credit Rating Agencies Regulation. The CRA provides that banks, investment firms, insurers, reinsurers, management companies, investment companies, alternative investment fund managers and CCPs may only use credit ratings for regulatory purposes issued by CRAs established in the EU and registered with ESMA. Credit ratings issued in a third country may be used for regulatory purposes in the EU under the endorsement regime or the equivalence/certification regime. Endorsement allows credit ratings issued by a third-country CRA and endorsed by an EU CRA to be used for regulatory purposes in the EU. The equivalence/certification regime allows credit ratings issued by a third-country CRA in relation to a third-country entity or financial instrument to be used in the EU for regulatory purposes—it does not cover ratings issued by a third-country CRA for an EU entity or a financial instrument issued in the EU.

The Guidelines on the endorsement regime follow changes that were introduced through an amendment to the CRA Regulation (known as CRA 3) which will apply from June 1, 2018. The updated Guidelines include three main changes to the existing Guidelines. First, where a third-country legal and supervisory framework has been positively assessed by ESMA, ESMA will no longer assume that compliance of the third-country CRA with this framework equates to compliance with requirements as stringent as those under the CRA Regulation. The endorsing CRA is expected to verify and be able to demonstrate that the third-country CRA has established internal requirements which are at least as stringent as the corresponding requirements in the relevant provisions of the CRA Regulation. Secondly, the updated Guidelines confirm that ESMA has the power to request information directly from the endorsing CRA about the

conduct of the third-country CRA and the endorsed credit rating. Thirdly, the updated Guidelines provide a list of what ESMA considers to be objective reasons for a credit rating to be elaborated in a third country. The Guidelines will apply to credit ratings issued on or from January 1, 2019 and to existing credit ratings reviewed after that date.

ESMA's Technical Advice to the European Commission on the equivalence of certain third-country legal and supervisory frameworks takes into account the additional equivalence requirements introduced under CRA 3. Four CRAs are currently certified by ESMA under the equivalence/certification regime—Japan Credit Rating Agency Ltd (Japan), Kroll Bond Rating Agency (US), HR Ratings de México, S.A. de C.V. (Mexico) and Egan-Jones Ratings Co. (US). ESMA has re-assessed the frameworks of those jurisdictions that were deemed equivalent to the EU regime before CRA 3—Argentina, Brazil, Mexico, US, Canada, Hong Kong, Singapore, Japan and Australia. ESMA concluded that only the regimes in Mexico, the US, Hong Kong and Japan could be considered equivalent to the revised EU regime. Canada could also be equivalent, provided that a proposed rulemaking is adopted and implemented in Canadian law before June 1, 2018.

The final Report and updated Guidelines are available at: https://www.esma.europa.eu/sites/default/files/library/esma33-9-205_final_report_on_the_application_of_the_cra_endorsement_regime_1.pdf and the Technical Advice is available at: https://www.esma.europa.eu/sites/default/files/library/esma33-9-207_technical_advice_on_cra_regulatory_equivalence_-_cra_3_update.pdf.

## Derivatives

### CFTC Extends No-Action Relief for Swap Execution Facilities from Certain Block Trade Requirements

On November 14, 2017, the Commodity Futures Trading Commission Division of Market Oversight extended previous time-limited no-action relief provided to swap execution facilities from certain requirements under the "block trade" definition in CFTC regulation 43.2. Under the CFTC rules, a "block trade" must "occur away from the registered SEF's or designated contract market's trading system or platform." In light of technical limitations on conducting required pre-trade credit checks for transactions that occur away from a SEF, the relief allows a SEF to execute block trades through its trading system or platform, provided that (1) the block trade is not executed on the SEF's order book functionality; (2) the SEF adopts rules requiring that each cleared block trade executed on its trading system or platform complies with other requirements under the "block trade" definition in CFTC regulation 43.2; (3) a registered futures commission merchant completes the required pre-execution credit check at the time the block trade order enters the SEF's non-order book trading system or platform; and (4) the block trade is void where it is rejected on the basis of credit.

The previous relief was scheduled to expire November 15, 2017 under CFTC Staff Letter 16-74. The new relief, issued under CFTC staff letter 17-60, is substantively identical and subject to the same conditions as the previous relief and is effective until November 15, 2020.

The Press Release is available at: http://www.cftc.gov/PressRoom/PressReleases/pr7645-17, CFTC Staff Letter 17-60 is available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/17-60.pdf and CFTC Staff Letter 16-74 is available at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-74.pdf.

### EU Proposed Guidelines on Position Calculation by a Trade Repository

On November 17, 2017, ESMA published proposed Guidelines on position calculation by trade repositories under the European Market Infrastructure Regulation. EMIR requires that derivatives contracts are reported to a trade repository by the parties to the contract or the CCP. Reporting parties do not have to report their trades to the same trade repositories. Instead, trade repositories must take steps to reconcile records among one another. Repositories are required to calculate the positions by class of derivatives and the reporting entity, based on the reports received. Trade

repositories are also required to publish aggregate positions by class of derivatives. ESMA is proposing new Guidelines for trade repositories on calculating the positions because trade repositories have adopted different and inconsistent approaches to position calculation which thwarts the aggregation of data across trade repositories for the purpose of monitoring systemic risks to financial stability. The proposed Guidelines seek to ensure consistency between trade repository position calculations so that overall entity-level positions can be determined by the supervising authorities. The proposed Guidelines include high-level principles and specific procedures for trade repositories to follow and require trade repositories to make available position data in four separate reports—a Position Set, Currency Position Set, Collateral Set and Collateral Currency Position Set.

ESMA is requesting feedback on the proposed Guidelines by January 15, 2018. ESMA expects to publish a final report and final Guidelines in the first half of 2018.

The proposed Guidelines are available at: https://www.esma.europa.eu/sites/default/files/library/esma70-151-819_consultation_paper_on_position_calculation.pdf.

## Financial Crime

### UK Joint Money Laundering Steering Group Consults on Minor Revisions to Its Anti-Money Laundering and Counter-Terrorism Financing Guidance

On November 17, 2017, the UK Joint Money Laundering Steering Group launched a consultation on proposed further revisions to its guidance on the prevention of money laundering and the financing of terrorism for the UK financial services industry.

The proposed revisions to the JMLSG's Guidance are of a minor nature and are being made to accommodate: (i) comments made by HM Treasury in the context of seeking Ministerial approval of the June 2017 version of the text; (ii) late changes made during the finalization of the new Money Laundering Regulations, published by HM Treasury on 22 June 2017, which affect some of the references in the text; and (iii) reference to some provisions of the Criminal Finances Act 2017 which came into force on September 30, 2017.

Due to the minor nature of the revisions, only a short consultation period is deemed necessary. Comments are therefore invited by December 4, 2017.

The JMLSG Press Release is available at: http://www.jmlsg.org.uk/news/the-joint-money-laundering-steering-group-jmlsg-today-publishes-proposed-fu?_sm_au_=iVVnrL26D6SHs2HV.

### UK Regulator Warns of Risks of Investing in Cryptocurrency CFDs and Binary Options

On November 14, 2017, the UK FCA issued two consumer warnings on the risks of investing in contracts for differences relating to cryptocurrencies (that is, digital assets such as Bitcoin or Ethereum) and the risks of trading binary options.

The FCA warns consumers that cryptocurrency CFDs are complex financial instruments that are an extremely high-risk, speculative investment. CFDs linked to cryptocurrencies allow investors to speculate on a change in price of a cryptocurrency. Cryptocurrencies themselves suffer from extreme price volatility, which means that the value of any linked CFDs is vulnerable to sharp changes in price due to unexpected events or changes in market sentiment. Another important risk inherent in these products is that the firms providing them can offer leverage of up to 50:1. While this can multiply returns, it can significantly amplify losses, with the result that an investor could not only rapidly lose their whole investment but also end up owing money to the CFD firm. The fees and charges applied to cryptocurrency CFDs tend to be much higher than for other CFDs, which has an impact on any potential profit. Finally, the FCA warns that lack of price transparency for cyrptocurrencies means that there is a risk that investors will not receive a fair and accurate price for the underlying cryptocurrency when trading.

Binary options allow investors to bet on the value or price of a stock, commodity, currency, index or other asset capable of being measured in financial terms. In its warning on binary options, the FCA warns that the majority of consumers lose money when trading binary options, as profitable trading in these products requires sophisticated financial knowledge. The products are priced in a complex way and the very short duration of the trades makes it very difficult for consumers to make an informed decision on value. These products also carry a significant risk of fraud from binary options scams that commonly promise higher than average returns for bets that never occur and manipulate software to distort prices and payouts. The FCA considers that there is a risk of poor conduct even from legitimate firms, due to conflicts of interest, as in most cases the firm a consumer buys options from stands to benefit if the consumer loses. Finally, the products resemble fixed odd bets and can be addictive, leading to the buildup of significant losses.

The Consumer Warning on Cryptocurrency CFDs is available at: https://www.fca.org.uk/news/news-stories/consumer-warning-about-risks-investing-cryptocurrency-cfds and the Consumer Warning on Binary Options is available at: https://www.fca.org.uk/news/news-stories/consumer-warning-about-risks-investing-binary-options.

## FinTech

### Federal Reserve Board Governor Lael Brainard Discusses the Impact of Fintech on Consumers

On November 16, 2017, US Federal Reserve Board Governor Lael Brainard discussed the evolution of FinTech including the impact in the consumer space and the important role that banks, data aggregators, consumers and other stakeholders play in the evolution of this fast-changing market. Brainard noted that consumers often are unaware of how their data is collected, who it is collected by and how it is used, which can present issues, particularly in the fast-moving and constantly evolving FinTech space. Governor Brainard highlighted the important role that the consumer plays in the FinTech market, and cautioned consumers against allowing their financial choices to be completely on autopilot without some consideration of the underlying processes.

Governor Brainard's speech is available at: https://www.federalreserve.gov/newsevents/speech/brainard20171116a.htm.

### European Securities and Markets Authority Issues Alerts to Firms and Investors on Initial Coin Offerings

On November 13, 2017, ESMA published a statement alerting investors about the high risks of investment in Initial Coin Offerings, including the risk of total loss of their investment. The statement is accompanied by an alert to EU firms involved in ICOs reminding them of their regulatory obligations.

ICOs are a means of raising money from the public, whereby the issuer issues coins or tokens to be purchased by investors in exchange for traditional currencies or, more often, virtual currencies such as Bitcoin or Ethereum. The coins or tokens are typically created and distributed using distributed ledger technology (DLT). In its statement to investors, ESMA cites the key risks of ICOs as: the fact that their structure may mean they are unregulated instruments; some recent ICOs have been fraudulent; ICOs are often used by start-ups with an inherent risk of failure, meaning a high risk of loss of invested capital; it may not be possible to trade the coins or tokens to exit the investment; there is a risk of extreme price volatility; information provided to investors can be limited; and the DLT technology underpinning ICOs is largely untested and may therefore potentially contain flaws.

In its alert to EU firms involved in ICOs, ESMA reminds firms of the need to consider whether their activities constitute regulated activities within the EU regulatory regime. Where activities constitute regulated activities, firms must comply with the relevant legislation. The coins or tokens issued in an ICO may, depending on their structure, classify as financial instruments and, where this is the case, firms engaged in placing, dealing or advising on ICOs, or managing or marketing investment schemes investing in coins or tokens are likely to be conducting regulated activities. Where ICOs are securities, then prospectus publication requirements and distribution restrictions may apply under the Prospectus Directive. Firms therefore have a duty to consider the regulatory framework, in particular the Prospectus Directive, the

Prospectus Regulation, the Markets in Financial Instruments Directive, the Alternative Investment Fund Managers Directive and the Fourth Money Laundering Directive. Firms must meet the applicable requirements and seek any necessary permissions.

The Alert to Investors is available at: https://www.esma.europa.eu/sites/default/files/library/esma50-157-829_ico_statement_investors.pdf and the Alert to Firms is available at: https://www.esma.europa.eu/sites/default/files/library/esma50-157-828_ico_statement_firms.pdf.

## Funds

### EU Authority Publishes Advice, Technical Standards and Guidelines under EU Money Market Funds Regulation

On November 17, 2017, ESMA published technical standards, technical advice and Guidelines under the Money Market Funds Regulation. These are: final draft Implementing Technical Standards providing a reporting template for managers of MMFs to use in fulfilling their quarterly reporting obligation to the relevant national regulator, which will include information on the characteristics, portfolio indicators, assets, and liabilities of the MMF; Technical Advice to the European Commission on liquidity and credit quality requirements applicable to assets received as part of a reverse repurchase agreement and on credit quality assessments and procedures for those assessments; and Guidelines on common reference parameters of the stress test scenarios to be included in the stress tests that managers of MMFs are required to conduct.

The MMF Regulation will apply from July 21, 2018, with the exception of certain requirements which applied from July 20, 2017, including the obligation on MMF managers to report information about each MMF they manages to the fund's national regulator. The final draft ITS on the reporting template have been submitted to the Commission for endorsement.

ESMA's final Report is available at: https://www.esma.europa.eu/sites/default/files/library/esma34-49-103_final_report_on_mmf_cp.pdf.

## MiFID II

### European Securities and Markets Authority Guidance Prohibits Non-EU Firms Offering Direct Electronic Access to EU Exchanges

On 15 November, 2017, ESMA published new guidance, in the form of an update to its questions and answers (Q&A) on the market structures aspects of the revised MiFID and related Markets in Financial Instruments Regulation. ESMA's Q&A include new guidance prohibiting non-EU entities from offering client trading services as EU exchange members. This concept is referred to as "direct electronic access" under MiFID II and incorporates both direct market access and sponsored access.

ESMA's Q&A mirror the wording of the MiFID II Directive, stating that an EU-regulated market that permits DEA must to have in place effective systems procedures and arrangements to ensure that members or participants are only permitted to provide such services if they are investment firms authorized under MiFID II or credit institutions authorized under the CRD. ESMA's Q&A are not legally binding. The ESMA guidance is at odds with the UK implementation of this requirement and seems to contradict article 54(1) of MiFIR. On its face, the guidance effectively prohibits the provision of DEA to EU exchanges by "third-country" firms that are not EU-authorized whilst allowing some structures whereby third-country clients can be intermediated by non-EU affiliates.

ESMA Questions and Answers on MiFID II and MiFIR Market Structures Topics are available at: https://www.esma.europa.eu/sites/default/files/library/esma70-872942901-38_qas_markets_structures_issues.pdf.

## People

### US Senate Approves Joseph Otting as Comptroller of the Currency

On November 16, 2017, the US Senate voted to confirm (54-43) the nomination of Joseph Otting as Comptroller of the Currency. Once officially sworn in, Otting will replace Acting Comptroller Keith Noreika.

### US Consumer Financial Protection Bureau Director to Step Down

On November 15, 2017, US Consumer Financial Protection Bureau Director Richard Cordray sent a memo to his staff announcing that he plans to leave his position by the end of the month. An interim or permanent successor has not yet been named although it has been widely reported that President Trump is considering naming OMB Director Mick Mulvaney as interim CFPB Director.

## Upcoming Events

November 24, 2017: European Commission public hearing on European corporate bonds markets

November 28, 2017: EBA 6th Annual Research Workshop—the future role of quantitative models in financial regulation

November 28, 2017: The US Department of the Treasury, the Federal Reserve Board, the Federal Reserve Bank of New York, the US Securities and Exchange Commission and the US Commodity Futures Trading Commission will hold their third conference on the Evolving Structure of the US Treasury Market to review current Treasury market structure and policy

November 28, 2017: US Senate Banking Committee is scheduled to conduct the nomination hearing for Jerome Powell to be Chairman of the Federal Reserve Board

November 30, 2017: ECB public hearing on proposed Guidance on quantitative supervisory expectations concerning the minimum levels of prudential provisions expected for non-performing exposures

January 22, 2018: EBA public hearing on draft RTS on the methods of prudential consolidation under the CRR

## Upcoming Consultation Deadlines

November 27, 2017: European Commission consultation on an Inception Impact Assessment for feedback on the possible introduction of legislation for crowdfunding and peer-to-peer lending

November 30, 2017: Comments due on the Federal Reserve's proposed guidance on supervisory expectations for boards of directors and its proposed new rating system for large financial institutions

November 30, 2017: ESMA consultation on Guidelines for non-significant benchmarks

November 30, 2017: European Commission consultation on proposals for statutory prudential backstops to address NPL build-up

December 4, 2017: Joint Money Laundering Steering Group consultation on minor revisions to JMLSG Guidance

December 8, 2017: ECB consultation on proposed Guidance on quantitative supervisory expectations concerning the minimum levels of prudential provisions expected for non-performing exposures

December 19, 2017: EBA consultation on significant risk transfer in securitization

January 12, 2018: PSR consultation (CP17/2) on authorized push payment scams

January 15, 2018: ESMA consultation on proposed Guidelines on the position calculation under EMIR

January 16, 2018: European Commission Legislative Proposals for Enhanced Powers for European Supervisory Authorities and the European Systemic Risk Board

January 25, 2018: ESMA consultation on amendments to Systematic Internalisers' quote rules under RTS 1 of MiFID II

February 2, 2018: BoE consultation on the procedure for the Enforcement Decision Making Committee

February 5, 2018: FCA consultation: Industry Codes of Conduct and Discussion Paper on FCA Principle 5

February 9, 2018: EBA consultation on draft RTS on the methods of prudential consolidation 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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