

# FINANCIAL REGULATORY DEVELOPMENTS FOCUS

In this week's newsletter, we provide a snapshot of the principal United States, 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 Government Accountability Office Releases Report Regarding US Federal Financial Institution Regulator Compliance With the Regulatory Flexibility Act

On January 30, 2018, the US Government Accountability Office released a report that details the compliance of six US federal financial institution regulators (the US Board of Governors of the Federal Reserve System, the US Office of the Comptroller of the Currency, the US Federal Deposit Insurance Corporation, the US Securities and Exchange Commission, the US Commodity Futures Trading Commission and the US Consumer Financial Protection Bureau) with the requirements of the Regulatory Flexibility Act (RFA). Under the RFA, regulators must either consider a proposed rule or regulation's impact on smaller financial institutions and consider potential alternatives, or certify that the proposed rule or regulation will not have a significant impact on a large percentage of small financial institutions. The GAO report identified a number of weaknesses with the agencies' compliance with both aspects of the RFA, including a lack of transparency with respect to documentation supporting an agency's regulatory flexibility analysis, and missing information in certifications. The GAO report makes 10 recommendations—each tailored to respond to perceived weaknesses at specific regulators—with each of the six reviewed agencies receiving at least one recommendation. The recommendations include enhancing transparency, developing policies and procedures that better document and explain the respective agency's analysis and requiring the agencies to review existing evaluation frameworks to ensure harmonization with the requirements of the RFA.

The full text of the GAO report is available at: <https://www.gao.gov/assets/690/689732.pdf>.

### Treasury Secretary Mnuchin Testifies Before the US Senate Committee on Banking, Housing & Urban Affairs

On January 30, 2018, Treasury Secretary Steven Mnuchin testified before the US Senate Committee on Banking, Housing & Urban Affairs at the committee's Financial Stability Oversight Council annual report to Congress hearing. In his prepared statement, Secretary Mnuchin noted that the FSOC annual report recommended that member agencies review existing rules and regulations to reduce overlap and duplication, modernize regulations that have become outdated and tailor regulations to fit the size and complexity of the financial institutions for which the regulations are applicable. Secretary Mnuchin praised Congress for the bipartisan Economic Growth, Regulatory Relief and Consumer Protection Act, a legislative proposal that seeks to ease the regulatory burden on smaller community-based financial institutions, and urged both the US Senate and the US House of Representatives to take quick action to reduce regulatory burdens. Secretary Mnuchin also stressed that cybersecurity is a key risk identified in the FSOC annual report. While Secretary Mnuchin stated that progress has been made with regard to cybersecurity, he highlighted the danger that a large-scale cybersecurity incident could significantly disrupt the financial system, especially given the ever-increasing reliance on technology.

The full text of Secretary Mnuchin's statement is available at:

[https://www.banking.senate.gov/public/\\_cache/files/54d399f5-242f-48a3-8640-fed2fa260816/17285300C5D5C0D3E02B7CB06B070267.mnuchin-testimony-1-30-18.pdf](https://www.banking.senate.gov/public/_cache/files/54d399f5-242f-48a3-8640-fed2fa260816/17285300C5D5C0D3E02B7CB06B070267.mnuchin-testimony-1-30-18.pdf).

### US House of Representatives Passes Five Bills Affecting Financial Institutions

On January 30, 2018, the US House of Representatives passed five bills focused on regulatory reform for financial institutions. The bills passed by the House include: the Housing Opportunities Made Easier Act (H.R. 2255), which amends the Truth in Lending Act to allow mortgage appraisal services to be donated to organizations eligible to receive tax-deductible contributions; the Federal Savings Association Charter Flexibility Act of 2017 (H.R. 1426), which would give certain federal savings associations the same rights and

privileges as national banks supervised by the US OCC; the Making Online Banking Initiation Legal and Easy (MOBILE) Act (H.R. 1457), which would permit financial institutions, upon an individual's request, to use a scan or other copy of an individual's identification card for identification and antifraud purposes, but also requires that the institution delete the scanned copy after the institution has completed its review; and the Financial Institution Living Will Improvement Act of 2017 (H.R. 4292), which would amend the Dodd-Frank Act to require bank holding companies to submit resolution plans to the US Board of Governors of the Federal Reserve System and the US FDIC every two years (as opposed to every year), require that the agencies provide feedback within six months after a submission is received and require increased transparency regarding the assessment framework used to evaluate the resolution plan submissions.

The full text of The Federal Savings Association Charter Flexibility Act of 2017 (H.R. 1426) is available at: <https://www.congress.gov/115/bills/hr1426/BILLS-115hr1426rfs.pdf>, The Making Online Banking Initiation Legal and Easy (MOBILE) Act (H.R. 1457) is available at: <https://www.congress.gov/115/bills/hr1457/BILLS-115hr1457rfs.pdf>, The Housing Opportunities Made Easier Act (H.R. 2255) is available at: <https://www.congress.gov/115/bills/hr2255/BILLS-115hr2255rfs.pdf> and The Financial Institution Living Will Improvement Act of 2017 (H.R. 4292) is available at: <https://www.congress.gov/115/bills/hr4292/BILLS-115hr4292eh.pdf>.

## Derivatives

### **US Commodity Futures Trading Commission Proposes New Measure to Calculate Size of Interest Rate Swap Markets**

The CFTC is considering a new measure to calculate the size of the interest rate swap (IRS) markets. Under the methodology proposed in a paper by CFTC Chief Economist Bruce Tuckman, the value of the IRS markets would be determined by the calculation of what the paper refers to as "Entity-Netted Notionals" (ENNPs) instead of the current gross notional measure used today, which the paper argues overstates risk transfer in the markets.

ENNPs would be calculated by: (1) converting the long and short notional amounts of each counterparty to five-year risk equivalents; (2) netting longs against shorts in a given currency within pairs of legal entities; and (3) summing the resulting net longs or shorts across counterparties. Under this calculation, the value of the current IRS markets would be approximately \$15 trillion, which represents roughly 8% of the current \$179 trillion market valuation under the current notional calculation.

In a speech introducing the paper, CFTC Chairman J. Christopher Giancarlo argued that the new measure would ensure the IRS markets are more easily compared to other markets, and, in particular, that it would bring their value closer to other fixed income markets, such as the markets for US Treasuries, corporate bonds, mortgages and municipal securities. However, he also acknowledged that ENNPs are not intended to measure counterparty or operational risk and said his intention is not necessarily to use the calculation to rethink regulatory thresholds, such as the swap dealer de minimis registration threshold.

The CFTC is looking for market reaction to the ENNPs proposal.

The Office of the Chief Economist's paper is available at: [http://www.cftc.gov/idc/groups/public/@economicanalysis/documents/file/oce\\_ennts0118.pdf](http://www.cftc.gov/idc/groups/public/@economicanalysis/documents/file/oce_ennts0118.pdf) and Chairman Giancarlo's speech is available at: <http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo35>.

## Enforcement

### **US Commodity Futures Trading Commission Fines Investment Bank for Attempted Manipulation of Benchmark Swaps Rate**

On February 1, 2018, the CFTC issued an order settling charges against the US investment arm of an international bank for attempted manipulation of the US dollar International Swaps and Derivatives Association Fix (USD ISDAFIX), a global benchmark that indicates the prevailing mid-market rate for the fixed leg of a standard fixed-for-floating interest rate swap.

The order alleges that from at least January 2007 through May 2012, the firm attempted to manipulate the USD ISDAFIX by bidding, offering and executing transactions in targeted interest rate products near the time of the benchmark's daily publication in order to influence the final published rate and improve the firm's positions. The order also alleges that certain employees of the firm who were responsible for making USD ISDAFIX submissions attempted to manipulate the published rate by submitting rates that were false and misleading in order to move the USD ISDAFIX to a more desirable level that would benefit the firm's positions.

The firm agreed to a \$70 million fine to settle the charges. In the order, the CFTC recognized the firm's cooperation with the investigation and remedial actions taken by the firm to strengthen internal controls and policies relating to all benchmarks, including the USD ISDAFIX.

The CFTC's press release is available at: <http://www.cftc.gov/PressRoom/PressReleases/pr7692-18>.

## Financial Market Infrastructure

### **EONIA Review Shelved**

On February 2, 2018, the administrator of the Euro OverNight Index Average, the European Money Markets Institute, announced its decision not to pursue a thorough review of the EONIA benchmark.

EONIA represents the weighted average of all overnight unsecured lending transactions in the interbank market undertaken in the European Union and European Free Trade Association countries. EMMI, which also administers Euribor, had been engaged in a review program since December 2015 with the objective of enhancing EONIA's governance and operation to align it with the requirements of the EU Benchmarks Regulation, which took effect on January 1, 2018.

Under the Benchmarks Regulation, index providers must apply for authorization or registration by January 1, 2020. Following its analysis of unsecured interbank money market activity undertaken as part of the EONIA review, EMMI has concluded that, should market conditions and dynamics remain unchanged and EONIA's definition and calculation methodology remain in its current format, EONIA's compliance with the Benchmarks Regulation by January 2020 "cannot be warranted". EONIA may be used as a reference rate, under the transitional provisions of the Benchmarks Regulation, until December 31, 2019 and daily publication of the rate will continue "as is." EMMI is also open to assessing whether methodological parameters could be adapted, if deemed necessary, to make the benchmark more robust. The Benchmarks Regulation sets out specific conditions that must be met after December 31, 2019, for the provision and use of EONIA in existing contracts.

The EMMI publication is available at: <https://www.emmi-benchmarks.eu/assets/files/D0030D-2018-Eonia-review-state-of-play.pdf>.

## **Results of EU-Wide CCP Stress Test 2017 Published**

On February 2, 2018, the European Securities and Markets Authority published a report setting out the results of its second EU-wide CCP stress test exercise. The European Market Infrastructure Regulation requires ESMA to conduct the exercise at least once per year to assess the resilience and safety of EU CCPs. The second stress test tested the resilience of 16 European CCPs, with approximately 900 clearing members EU-wide.

The 2017 stress test builds on the first stress test conducted in 2016, which only examined counterparty credit risk. The second stress test included liquidity risks and examined whether CCPs would meet their liquidity needs under different stress scenarios. ESMA has published some Q&A to accompany the report.

The ESMA report is available at: <http://firds.esma.europa.eu/webst/ESMA70-151-1154%20EU-wide%20CCP%20Stress%20Test%202017%20Report.pdf> and the ESMA Q&A are available at: <http://firds.esma.europa.eu/webst/ESMA70-151-1179%202nd%20CCP%20stress%20test%20FAQ.pdf>.

## **FinTech**

### **EU Blockchain Observatory and Forum Launched**

On February 1, 2018, the European Commission announced the launch of the EU Blockchain Observatory and Forum. The Commission intends the new Forum to build on existing initiatives and to ensure the feasibility of Blockchain use cross-border. It is also expected to assist in tackling difficulties arising from the use of Blockchain, such as disintermediation, trust, security and traceability. Furthermore, the Blockchain Observatory and Forum will support cross-border cooperation on practical use cases and be an open forum for discussing and developing new ideas.

The Commission's FinTech Action Plan is expected to be issued in Spring.

The press release is available at: [http://europa.eu/rapid/press-release\\_IP-18-521\\_en.htm](http://europa.eu/rapid/press-release_IP-18-521_en.htm).

## **Funds**

### **International Standards Body Issues Liquidity Risk Management Recommendations for Funds**

On February 1, 2018, the International Organization of Securities Commissions published its final report and recommendations on liquidity risk management for open-ended collective investment schemes. It has also published a report on good practices and considerations in open-ended fund liquidity and risk management. These reports follow the consultation run last year and constitute IOSCO's final response to the Financial Stability Board Policy Recommendations to Address Structural Vulnerabilities from Asset Management Activities, published in January 2017, which called on IOSCO to review and revise its guidance, where appropriate.

The first report, Recommendations for Liquidity Risk Management for Collective Investment Schemes, sets out recommendations for managing the liquidity of CIS to ensure the protection of investor's interests, including in stressed market conditions. The Recommendations are addressed to those responsible for liquidity risk management of CIS and to national regulators. There are 17 recommendations covering the CIS design process, day-to-day liquidity management and contingency planning. The report replaces IOSCO's 2013 report on liquidity risk management for CIS.

The second report, Open-ended Fund Liquidity and Risk Management – Good Practices and Issues for Consideration, aims to assist regulators, industry participants and investors. It provides information on how

various jurisdictions regulate liquidity risk management, sets out best practices for liquidity risk management throughout the life cycle of a fund and describes the scenarios in which an asset manager might use certain tools to manage liquidity in funds. The Good Practices document is intended to provide entities implementing the Recommendations with a reference guide to assess their approach against those adopted by others.

IOSCO expects national regulators to promote the implementation of the 2018 Liquidity Recommendations but notes that the specific jurisdictional requirements will lead to varied implementation. IOSCO intends to assess implementation across jurisdictions in two to three years.

The 2018 Liquidity Recommendations are available at:

[http://www.iosco.org/library/pubdocs/pdf/IOSCOPD590.pdf?\\_sm\\_au\\_=iVVHFMWksMD40nsR](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD590.pdf?_sm_au_=iVVHFMWksMD40nsR) and the Good Practices Report is available at:

[http://www.iosco.org/library/pubdocs/pdf/IOSCOPD591.pdf?\\_sm\\_au\\_=iVVHFMWksMD40nsR](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD591.pdf?_sm_au_=iVVHFMWksMD40nsR).

### **European Commission Confirms Reverse Distribution Not Permitted Under Money Market Funds Regulation**

On February 5, 2018, the European Commission published a letter to the European Securities and Markets Authority in response to a query from ESMA on the interpretation of the Money Market Funds Regulation concerning “reverse distribution.” Reverse distribution involves the cancellation of fund units in certain market environments, notably where negative interest rates prevail.

ESMA had concluded, in its public consultation on its draft Implementing Technical Standards for the MMFR, that the reverse distribution mechanism (often referred to as “share cancellation” or “share destruction”) was not compatible with MMFR. ESMA’s final draft ITS therefore did not provide for information on the “destruction” of shares to be included in quarterly reporting to national regulators. ESMA received industry feedback to its consultation to the effect that reverse distribution is a common market practice, accepted by both national regulators and investors. ESMA sought legal advice from the Commission. The Commission’s response, dated January 19, 2018, confirms that reverse distribution is not compatible with the MMFR, and invites ESMA to issue guidance to ensure supervisory convergence on this issue.

The letter is available at:

[http://firds.esma.europa.eu/webst/20180119\\_Reply%20to%20Mr%20Maijor%20on%20MMF.pdf](http://firds.esma.europa.eu/webst/20180119_Reply%20to%20Mr%20Maijor%20on%20MMF.pdf).

## **People**

### **Jerome Powell Sworn in as Chairman of the US Board of Governors of the Federal Reserve System**

On February 5, 2018, Jerome Powell was sworn in as Chairman of the US Board of Governors of the Federal Reserve System. Mr. Powell also serves as Chairman of the Federal Open Market Committee.

The Federal Reserve Board press release is available at:

<https://www.federalreserve.gov/newsevents/pressreleases/monetary20180131c.htm>.

### **Nausicaa Delfas Appointed as Executive Directive of International at the Financial Conduct Authority**

On February 1, 2018, the Financial Conduct Authority appointed Nausicaa Delfas as Executive Directive of International. The appointment creates a new role at the FCA and highlights the importance of developing the FCA’s strategy for international engagement, especially in the lead up to the UK’s withdrawal from the EU.

The FCA’s press release is available at: <https://www.fca.org.uk/news/press-releases/nausicaa-delfas-appointed-executive-director-international>.

## Upcoming Events

February 19, 2018: PRA and FCA New Bank Start-up Unit Seminar

February 19, 2018: Joint EBA and ESMA public hearing on consultations on draft RTS and ITS under the STS Regulation

March 22, 2018: UK Government's second annual International Fintech Conference

## Upcoming Consultation Deadlines

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

February 15, 2018: 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

February 21, 2018: FCA consultation on transitioning FCA solo-regulated firms and individuals to SM&CR (CP 17/40)

February 21, 2018: FCA consultation on transitioning insurers and individuals to SM&CR (CP 17/41)

February 21, 2018: FCA consultation on the duty of responsibility for insurers and FCA solo-regulated firms under the SM&CR (CP 17/42)

February 21, 2018: PRA consultation—extending the SM&CR to insurers (CP 28/17)

February 23, 2018: European Commission proposals to revise the prudential regime for investment firms

February 26, 2018: European Commission consultation on SME listing

February 27, 2018: PRA consultation on authorization and supervision of international banks (CP29/17)

February 27, 2018: PRA consultation on authorization and supervision of international insurers (CP30/17)

February 28, 2018: European Commission consultation on supervisory reporting requirements

February 28, 2018: ESMA consultation on draft guidelines on the requirement for CCPs to adopt anti-procyclicality margin measures

March 5, 2018: Comments to Federal Reserve Board's Proposed Regulation M Revisions due

March 5, 2018: Comments to Federal Reserve Board's Proposed Call Report Revisions due

March 6, 2018: PRA consultation on proposed updates to the Pillar 2 reporting requirements

March 6, 2018: PRA consultation on model risk management principles for stress testing

March 9, 2018: Basel Committee discussion paper on the regulatory treatment of sovereign exposures

March 9, 2018: ESMA consultation on draft RTS under the new Prospectus Regulation (ESMA31-62-802)

March 15, 2018: Comments to Federal Reserve Board's proposed guidance clarifying risk management supervisory expectations for large financial institutions due

March 15, 2018: EBA Discussion Paper on EU implementation of the revised market risk and counterparty credit risk frameworks

March 15, 2018: EBA consultation on draft RTS for risk retention under STS Regulation

March 15, 2018: EBA consultation on draft RTS on homogeneity of underlying exposures in STS securitizations under the STS Regulation

March 19, 2018: ESMA consultation on draft technical standards on the content and format of the “Simple, Transparent and Standardized” notification under the STS Regulation

March 19, 2018: ESMA consultation on draft technical standards on disclosure requirements, operational standards and access conditions under the STS Regulation

March 19, 2018: ESMA consultation on draft technical standards on third-party firms providing STS verification services under the STS Regulation

March 23, 2018: Basel Committee consultation on revised principles for supervisory and bank stress testing

March 23, 2018: FCA consultation on Handbook changes for implementation of the Money Market Funds Regulation

April 9, 2018: PRA consultation on MREL reporting requirements

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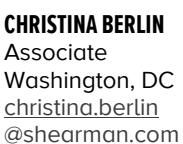
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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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