

FINANCIAL REGULATORY DEVELOPMENTS FOCUS

In this week’s newsletter, we provide a snapshot of the principal U.S., 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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AML/CTF, Sanctions and Insider Trading

FFIEC Publishes Customer Due Diligence and Beneficial Ownership Overviews and Examination Procedures

On May 11, 2018, the U.S. Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation published the customer due diligence and beneficial ownership examination sections of the Federal Financial Institutions Examination Council BSA/AML Examination Manual. This release coincided with the May 11, 2018 compliance date for the Customer Due Diligence Requirements for Financial Institutions rule issued by the U.S. Treasury Department's Financial Crimes Enforcement Network on May 11, 2016, which enumerates explicit customer due diligence program requirements, including a requirement to identify and verify the beneficial owners of legal entity customers. The updated customer due diligence section of the manual provides an overview of customer due diligence requirements for financial institutions, including obligations related to maintaining a customer risk profile, establishing risk-based procedures for collecting customer information—including guidance with respect to higher-risk-profile customers—and ongoing monitoring of customer relationships. This section also includes examination procedures for regulators, including transaction testing, in order to assess a financial institution's compliance with the customer due diligence requirements. The beneficial ownership section of the manual discusses the regulatory requirements for financial institutions to identify and verify the beneficial owners of legal entity customers. This section discusses the definition of legal entity customers, the control and ownership prongs of beneficial ownership, identification and verification of beneficial ownership information, recordkeeping and retention requirements and a financial institution's ability to rely on another financial institution for performance of the obligations under the beneficial ownership rule. The Beneficial Ownership examination procedures also provide an appendix that discusses exclusions and exceptions under the rule.

The customer due diligence rule examination procedures are available at:

[https://www.ffiec.gov/press/pdf/Customer%20Due%20Diligence%20-](https://www.ffiec.gov/press/pdf/Customer%20Due%20Diligence%20-%20Overview%20and%20Exam%20Procedures-FINAL.pdf)

[%20Overview%20and%20Exam%20Procedures-FINAL.pdf](https://www.ffiec.gov/press/pdf/Customer%20Due%20Diligence%20-%20Overview%20and%20Exam%20Procedures-FINAL.pdf) and the beneficial ownership rule examination procedures are available at:

[https://www.ffiec.gov/press/pdf/Beneficial%20Ownership%20Requirements%20for%20Legal%20Entity%20Cu](https://www.ffiec.gov/press/pdf/Beneficial%20Ownership%20Requirements%20for%20Legal%20Entity%20CustomersOverview-FINAL.pdf)
[stomersOverview-FINAL.pdf](https://www.ffiec.gov/press/pdf/Beneficial%20Ownership%20Requirements%20for%20Legal%20Entity%20CustomersOverview-FINAL.pdf).

European Commission Adopts Delegated Legislation on Central Contact Points for AML/CTF Purposes

On July 5, 2018, the European Commission adopted a draft delegated regulation under the Fourth Money Laundering Directive. The draft regulation sets out Regulatory Technical Standards on the criteria that EU Member States should use when deciding whether or not payment service providers or electronic money institutions that are headquartered in another EEA Member State and that operate establishments (other than a branch) in their territory should appoint a central contact point for compliance with anti-money laundering and counter-terrorist financing obligations. The draft regulation also sets out RTS on the functions that may be entrusted to such a central contact point.

The draft regulation will now be subject to a three-month scrutiny period by the European Parliament and the Council of the European Union. Following this period, should neither of the co-legislators object, the draft regulation will then be published in the Official Journal of the European Union and enter into force 20 days later. Once in force, the delegated regulation will have direct effect across the EU.

The draft delegated regulation is available at: <http://ec.europa.eu/transparency/regdoc/rep/3/2018/EN/C-2018-2716-F1-EN-MAIN-PART-1.PDF>.

Bank Prudential Regulation & Regulatory Capital

Eurozone Risk Data Aggregation and Risk Reporting Needs Strengthening

On May 8, 2018, the European Central Bank published a report on the thematic review on effective risk data aggregation and risk reporting. The ECB launched the thematic review in 2016 to carry out an in-depth assessment of credit institutions' governance, data aggregation capabilities and reporting practices. The thematic review was based on 25 Eurozone significant institutions and took into account the Basel Committee on Banking Supervision's principles for effective risk data aggregation and risk reporting.

The ECB has ascertained that implementation of the Basel Committee's principles is unsatisfactory and that the issues are mostly as a result of a lack of clarity around responsibility for data quality. The ECB considers that further efforts are needed to enhance the effectiveness of risk data aggregation and risk reporting.

The report is available at:

https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.BCBS_239_report_201805.pdf?3a832ee84c8bc90496b943aa76a76bc4.

European Banking Authority to Provide Technical Advice on Implementation of Final Basel III Reforms

On May 7, 2018, the European Banking Authority announced that the European Commission had requested technical advice on implementing the final Basel III reforms into EU law. The Basel Committee published the final revisions to Basel III on December 7, 2017. The revisions cover the standardized approach and the Internal Ratings-Based approach for credit risk, the Credit Valuation Adjustment risk framework, the leverage ratio framework, including the introduction of a leverage buffer for Global Systemically Important Banks, the operational risk framework and the new output ratio floor. The revised standards will take effect from January 1, 2022, except for the output floor which may be phased-in until January 1, 2027.

The Commission has asked the EBA to provide technical advice on the potential impact of the revisions on the EU banking sector and the wider EU economy and on any potential implementation challenges. The Commission has also requested that the EBA consider the potential changes to the Basel market risk framework, on which the Basel Committee is currently consulting. Implementing the Basel III reforms, including any changes to the market risk framework, will mean changing the Capital Requirements Directive and the Capital Requirements Regulation as well as the relevant underlying technical standards.

The European Commission has asked the EBA to deliver its report by June 30, 2019. However, should it not be possible to provide the analysis on the CVA and market risk rules by that date, the EBA may deliver that portion of its advice by September 30, 2019 at the latest. The EBA intends to launch a data collection exercise in July this year, with further information on the scope of the exercise expected in the coming months.

The EBA's announcement, the call for advice and the Commission's letter are available at

http://www.eba.europa.eu/-/eba-will-support-the-commission-in-the-implementation-of-the-basel-iii-framework-in-the-eu?_sm_au_=iVV6J6sfkqRP7JR, details of the final Basel III reforms are available at: <https://finreg.shearman.com/basel-iii-finally-finalized> and details of the proposed revisions to the Basel market risk framework are available at: <https://finreg.shearman.com/basel-committee-consults-on-proposed-revisions-to>.

Compensation

Financial Stability Board Consults on Reporting on the Use of Compensation Tools to Address Misconduct Risk

On May 7, 2018, the Financial Stability Board published proposed Recommendations for consistent national reporting of data concerning the use of compensation tools to address misconduct risk in significant financial institutions. The FSB is proposing a supervisory framework for the collection and reporting of data, which can be used by supervisors for monitoring and analyzing the effectiveness of compensation frameworks in addressing misconduct risk. The information so collected is intended to assist supervisors to understand and review: (i) the importance of individual conduct within the firm's incentive compensation framework and the role of compensation policy in establishing a sound risk and conduct culture; and (ii) the use of compensation tools in practice and their role in ensuring accountability when misconduct occurs.

The proposed Recommendations are directed to relevant national supervisory authorities for firms in all financial sectors. For the banking sector, the proposals take into account disclosures of compensation required under the Basel Committee's Pillar 3 framework.

Alongside the consultation paper, the FSB has also published a summary of an industry workshop held in December 2017, which informed the FSB's work in developing the proposed Recommendations.

The FSB is seeking feedback on the proposed Recommendations as well as on nine specific questions relating to the scope of data that should be collected, impediments to the collection or use of data, relevance of data and the types of information that have been most useful to firms in monitoring and assessment of potential misconduct. The FSB also welcomes feedback on the topics covered in the workshop summary note. The consultation closes on July 6, 2018.

The consultation paper is available at: <http://www.fsb.org/wp-content/uploads/P070518-1.pdf> and the Workshop summary note is available at: <http://www.fsb.org/wp-content/uploads/P070518-2.pdf>.

Competition

UK Competition and Markets Authority Issues Working Paper on Gains from Engagement as Part of Its Investment Consultants Market Investigation

On May 10, the U.K. Competition and Markets Authority issued the latest in a series of working papers as part of its Investment Consultants Market Investigation. This latest Working Paper sets out the CMA's findings following its analysis of whether pension schemes that are more engaged with the market receive better outcomes, in terms of price, than pension schemes that are less engaged. It should be read alongside the Issues Statement on the investigation, published in September 2017, as well as the other working papers, published earlier in 2018.

The CMA's emerging findings are that engaged schemes pay significantly less, and disengaged schemes pay significantly more, when schemes transition into fiduciary management with the same provider as they used for investment consultancy services. The CMA believes that this is indicative that the market is not working well for disengaged schemes, or for schemes facing barriers to engagement.

Comments on the Working Paper are invited by May 24, 2018. All working papers will feed into the CMA's provisional decision report, to be published in July 2018.

The Working Paper on Gains from Engagement is available at: <https://assets.publishing.service.gov.uk/media/5af4642d40f0b622dd7aa215/working-paper-gains-from-engagement.pdf>, the Issues Statement is available at:

<https://assets.publishing.service.gov.uk/media/59c376f7ed915d408c10d131/investment-consultancy-market-investigation-issues-statement.pdf> and the Investigation Webpage and Other Working Papers are available at: <https://www.gov.uk/cma-cases/investment-consultants-market-investigation>.

Payment Services

Final Global Strategy to Address Wholesale Payments Fraud

On May 8, 2018, following a consultation late last year, the Committee on Payments and Market Infrastructure published the final strategy for reducing the risk of wholesale payments fraud related to endpoint security. The strategy is directed to all relevant public and private sector stakeholders in reducing the risk of wholesale payments fraud, including the operators of wholesale payments systems and messaging networks, their participants and relevant regulators and authorities responsible for supervising these operators and participants.

The strategy comprises seven elements that are intended to work holistically for preventing, detecting, responding to and communicating about wholesale payments fraud. The elements are:

- I. identifying and understanding the range of risks;
- II. establishing endpoint security requirements;
- III. promoting adherence;
- IV. providing and using information and tools to improve prevention and detection;
- V. responding in a timely way to potential fraud;
- VI. supporting ongoing education, awareness and information-sharing; and
- VII. learning, evolving and coordinating.

The CPMI and each of its member central banks have committed to promoting the effective operationalization of the strategy within and across jurisdictions and systems. They will be monitoring progress in 2018 and 2019 with a view to assessing whether further action is needed.

The strategy is available at: <https://www.bis.org/cpmi/publ/d178.pdf>.

Securities

Draft UK Legislation Published to Broaden Range of Permitted Trading Venues for Islamic Finance Instruments

On May 9, 2018, a draft of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2018 was laid before Parliament. The draft Order makes amendments to the definition of Alternative Finance Investment Bonds in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

AFIBs, such as Sukuk, are currently not permitted to trade on multilateral trading facilities or organised trading facilities, due to the wording of the AFIB definition in the RAO. However, conventional bonds can be traded on these venues. This disparity of treatment between AFIBs and conventional bonds creates an obstacle to the use of U.K. venues for the issue and trading of AFIBs and is contrary to the U.K. Government's standing commitment to provide a level playing field for Islamic finance instruments in regulation and taxation in the U.K. The draft Order amends the RAO to expand the criteria for AFIBs to qualify as a specified investment under the RAO. This will allow AFIBs to be traded on U.K. MTFs and OTFs and ensure AFIBs are treated in the same way as conventional bonds for trading purposes.

The draft Order also amends the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001, so that a person administering a benchmark as specified in the RAO will be regarded as carrying on the activity by way of business and will therefore require authorization under the Financial Services and Markets Act 2000 to do so.

The draft Order will come into force on the day after the day on which it is made. No impact assessment was produced for this instrument as no significant impact on the costs of business or the voluntary sector is foreseen.

The draft Order is available at:

http://www.legislation.gov.uk/ukdsi/2018/9780111169292/pdfs/ukdsi_9780111169292_en.pdf, the explanatory memorandum to the draft Order is available at:

http://www.legislation.gov.uk/ukdsi/2018/9780111169292/pdfs/ukdsiem_9780111169292_en.pdf and the de minimis statement accompanying the draft Order is available at:

http://www.legislation.gov.uk/ukdsi/2018/9780111169292/pdfs/ukdsiod_9780111169292_en.pdf.

People

Jens Weidmann Re-Elected as Chair of the Bank of International Settlements Board

On May 8, 2018, the Board of Directors of the Bank for International Settlements announced the re-election of Jens Weidmann, President of the Deutsche Bundesbank, as Chair of the BIS Board.

The announcement is available at: <https://www.bis.org/press/p180508a.htm>.

Upcoming Events

May 16, 2018: U.S. House Financial Services Committee hearing on the Implementation of FinCEN's Customer Due Diligence Rule

May 31, 2018: Bank of England and Centre for Economic Policy Research conference on competition and regulation in financial markets

May 31, 2018: public hearing on ESAs' consultations on amendments to EMIR RTS in the context of the Securitization Regulation

June 12, 2018: FCA Asset Management Conference

June 27, 2018: EBA public hearing on draft Guidelines on disclosure of non-performing and forborne exposures (registration closes June 5, 2018)

Upcoming Consultation Deadlines

May 21, 2018: Federal Reserve and OCC proposed amendments to supplementary leverage ratio calculations for GSIBs and their insured depository institution subsidiaries

May 23, 2018: European Commission's legislative proposals to address NPL build-up in the EU

May 23, 2018: European Commission's proposed Regulation on the law applicable to the third-party effects of assignments of claims

- May 23, 2018: ESMA consultations on draft technical standards on the application for registration of a securitization repository and on draft advice to the European Commission on supervisory fees for securitization repositories
- May 24, 2018: FSB second consultation on UPI governance
- May 25, 2018: ESMA consultation on supplementary guidance on the CRA endorsement regime
- May 25, 2018: Basel Committee consultation on revisions to Pillar 3 Framework
- May 27, 2018: EBA consultation on extending the Joint Committee Guidelines on complaints-handling for the securities and banking sectors
- May 28, 2018: ECB consultation on proposed guide to internal models
- June 4, 2018: European Commission proposed EU covered bonds legislative package
- June 5, 2018: HM Treasury consultation on cash and digital payments in the new economy
- June 5, 2018: ECB consultation on cyber resilience oversight expectations for Eurozone FMIs
- June 8, 2018: PSR consultation on its review of PSR Directions made in 2015
- June 8, 2018: EBA consultation on draft EBA Guidelines on Management of NPEs
- June 12, 2018: European Commission proposed amending Regulation on cross-border payments in the EU
- June 15, 2018: ESAs' consultation on revised RTS relating to the EMIR clearing obligation for certain classes of OTC derivatives
- June 15, 2018: ESAs' consultation on revised RTS on risk-mitigation techniques for OTC derivative contracts not cleared by a CCP
- June 20, 2018: FCA consultation on Model Driven Machine Executable Regulatory Reporting
- June 20, 2018: Basel Committee consultation on revisions to minimum capital requirements for market risk
- June 21, 2018: FCA consultation on its approach to supervision
- June 21, 2018: FCA consultation on its approach to enforcement
- June 28, 2018: FCA consultation on revising the Financial Crime Guide to include insider dealing and market manipulation
- July 5, 2018: FCA consultation on improving disclosure by AFMs to their investors (part of the Asset Management Market Study)
- July 6, 2018: FSB consultation on proposed Recommendations for consistent national reporting of data on the use of compensation tools to address misconduct risk
- July 9, 2018: FCA consultation on its approach to ex post impact evaluation
- July 17, 2018: EBA consultation on draft Guidelines on the exposures to be associated with high risk
- July 20, 2018: EBA consultation on draft guidelines on STS criteria for ABCP securitization and for non-ABCP securitization
- July 27, 2018: EBA consultation on draft Guidelines on disclosure of non-performing and forborne exposures

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:

CONTACTS



BARNEY REYNOLDS
Partner
London
barney.reynolds@shearman.com



REENA AGRAWAL SAHNI
Partner
New York
reena.sahni@shearman.com



RUSSELL SACKS
Partner
New York
rsacks@shearman.com



THOMAS DONEGAN
Partner
London
thomas.donegan@shearman.com



SUSANNA CHARLWOOD
Partner
London
susanna.charlwood@shearman.com



DONNA PARISI
Partner
New York
dparisi@shearman.com



NATHAN GREENE
Partner
New York
ngreene@shearman.com



GEOFFREY GOLDMAN
Partner
New York
geoffrey.goldman@shearman.com



JOHN ADAMS
Partner
London
john.adams@shearman.com



PHILIP UROFSKY
Partner
Washington D.C.
philip.urofsky@shearman.com



ELIAS ALLAHYARI
Associate
London
elias.allahyari@shearman.com



CHRISTINA BERLIN
Associate
Washington, DC
christina.berlin@shearman.com



TIMOTHY J. BYRNE
Counsel
New York
tim.byrne@shearman.com



TOBIA CROFF
Partner
Milan
tobia.croff@shearman.com



DANIEL FROST
Associate
London
daniel.frost@shearman.com



MATTHEW HUMPHREYS
Associate
London
matthew.humphreys@shearman.com



THOMAS JONES
Associate
London
thomas.jones@shearman.com



JENNY DING JORDAN
Associate
New York
jenny.jordan@shearman.com



P. SEAN KELLY
Associate
New York
sean.kelly@shearman.com



JENNIFER SCOTT KONKKO
Associate
New York
jennifer.konko@shearman.com



HERVÉ LETRÉGUILLY
Partner
Paris
hletreguilly@shearman.com



OLIVER LINCH
Associate
London
oliver.linch@shearman.com



JENNIFER D. MORTON
Counsel
New York
jennifer.morton@shearman.com



WILF ODGERS
Associate
London
wilf.odgers@shearman.com



MATTHEW READINGS
Partner
London
matthew.readings@shearman.com



BRADLEY K. SABEL
Of Counsel
New York
bsabel@shearman.com



INYOONG SONG
Associate
London
inyoung.song@shearman.com



KOLJA STEHL
Counsel
London
kolja.stehl@shearman.com



ELLERINA TEO
Associate
London
ellie.teo@shearman.com

ABU DHABI • AUSTIN • BEIJING • BRUSSELS • DUBAI • FRANKFURT • HONG KONG • HOUSTON • LONDON • MENLO PARK • MILAN • NEW YORK
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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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