

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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Brexit for Financial Services

UK Post-Brexit Secondary Legislation on Short Selling Published

On August 9, 2018, draft U.K. secondary legislation was published to onshore the EU Short Selling Regulation on the day the U.K. exits the EU. The draft Short Selling (Amendment) (EU Exit) Regulations 2018 (or U.K. SSRs) are expected to be laid before Parliament in Autumn 2018 and to come into force mostly on the day the U.K. withdraws from the EU. The draft U.K. SSRs are made under the provisions of the European Union (Withdrawal) Act 2018 to address failures of retained EU law relating to short selling to operate effectively and other deficiencies arising from Brexit.

The explanatory guide to the U.K. SSRs states that changes for firms with shares admitted to trading on a U.K. venue should be minimal. The procedure for notifying U.K. instruments to the Financial Conduct Authority will be kept and instruments admitted to trading on U.K. venues will continue to have the same restrictions applied to them.

The U.K. SSRs will amend the Financial Services and Markets Act 2000, as well as the EU SSR (incorporated into U.K. law by the European Union (Withdrawal) Act) and level 2 legislation under it for U.K. purposes after Brexit takes effect. Changes made by the draft U.K. SSR include:

- I. the U.K. SSR will only cover instruments admitted to trading on U.K. trading venues and U.K. sovereign debt and will not cover instruments admitted to trading or traded on an EEA trading venue or the sovereign debt of EEA governments.
- II. provisions facilitating cooperation and coordination between EU national regulators will be deleted.
- III. the FCA will assume the European Securities and Markets Authority's responsibility for collating and publishing the list of shares principally traded in a third country, including shares which have their principal trading venue outside of the U.K. This relates to the EU SSR exemptions from the reporting requirements, the buy-in regime and restrictions on uncovered short selling for shares which are principally traded in a third country. To ensure continuity, the FCA may recognize ESMA's existing list for up to two years following exit day.
- IV. provision to ensure that notifications by market makers of their intention to use the exemption available under the EU SSR made to the FCA before exit day will remain valid. European market makers will be required to join a U.K. trading venue and submit a notification to the FCA at least 30 days ahead of exit day to benefit from the exemption.
- V. the FCA will continue to have powers to restrict short selling in the event of a significant fall in the price of a share or in response to a threat to U.K. financial stability or market confidence.
- VI. provision to ensure that U.K. firms can continue to use U.K. sovereign CDS to hedge correlated assets or liabilities issued by issuers located outside of the U.K. anywhere in the world, instead of only in the EU. This is another example of Brexit being used to fix problematic EU legislation from a third country perspective as part of the "global Britain" agenda, and builds on the separate proposals relating to settlement finality designation.

HM Treasury has also published draft secondary legislation and proposals in other areas, such as a temporary permissions regime for EEA firms, a temporary recognition regime for non-U.K. CCPs and a proposed framework for U.K. settlement finality designation. The U.K. financial services regulators are expected to consult in the autumn on how changes will be made to their rules in these and other areas. Further draft financial services legislation is expected to be published in the lead up to Brexit.

The draft U.K. SSR are available at:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/732836/Short_Selling__EU_Exit_Regulations_draft_SI.pdf and the explanatory guidance to the draft U.K. SSR is available at: <https://www.gov.uk/government/publications/draft-short-selling-amendment-eu-exit-regulations-2018/short-selling-amendment-eu-exit-regulations-2018-explanatory-information>.

UK Financial Conduct Authority Confirms It Is Open to a Range of Booking Models for Brexit Preparations

On August 8, 2018, the FCA published a “Dear CEO” letter on firms’ cross-border booking models in preparation for Brexit. In the letter the FCA reminds firms that where the firm is expanding its European presence, it must still be possible for the FCA to supervise the firm’s U.K. business and firms must still meet their threshold conditions. However, unlike other EU regulators, the FCA is not stipulating specific requirements for booking models. Instead, the FCA states that it is “open to a broad range of legal entity structures or booking models. This includes those making use of back-to-back and remote booking, providing their associated conduct risks are effectively controlled and managed. Our starting point is therefore not to restrict business models but to understand the principles and practice involved and how the conduct risks that arise from them are managed.”

The FCA therefore states that booking models should comply with the following principles and be able to demonstrate how they have been implemented:

- I. firms establish a clear rationale for their booking arrangements, document them and have them approved by the Board;
- II. a firm’s risk management is appropriate for the firm’s booking activities, including hedging arrangements;
- III. firms are able to show that there is a broad alignment of risk and returns at the entity level;
- IV. firms have adequate systems and controls in place to ensure that booking arrangements are followed;
- V. firms have considered whether responsibility for oversight of booking arrangements should be explicit in statements of responsibilities under the Senior Managers Regime; and
- VI. booking arrangements should not be an impediment to the firm’s recovery and resolution.

The letter is available at: <https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-cross-border-booking-arrangements.pdf>.

Derivatives

EU and UK Authorities Clarify Trading Obligation Expectations for Pension Schemes

On August 8, 2018, the European Securities and Markets Authority published a further statement on the transitional exemption from the clearing obligation for pension scheme arrangements under the European Market Infrastructure Regulation and delegated regulations. Transitional provisions provide for PSAs to be exempt from the clearing obligation until August 16, 2018. There is no provision in EMIR that would allow for a further extension of this exemption period. It is proposed that this exemption will be further extended under the proposal to amend EMIR, known as EMIR Refit. ESMA issued a statement on July 3, 2018 stating that national regulators are expected not to prioritize “their supervisory actions towards entities that are expected to be exempted again in a relatively short period of time and to generally apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation in a proportionate manner.”

This new statement clarifies that ESMA does not expect national regulators to focus on any non-compliance by PSAs with the related trading obligation under the Markets in Financial Instruments Regulation. Financial counterparties that are exempt from the clearing obligation under EMIR are also exempt from the trading obligation under MiFIR. It is likely that the clearing obligation exemption will expire before it is extended under EMIR Refit and therefore the trading obligation exemption would also lapse.

The length of the extension under EMIR Refit is yet to be agreed as part of the legislative process between the European Parliament (which advocates a two-year extension) and the Council of the European Union (which supports a three-year extension). Parliament is also proposing to backdate the application of the new

transitional period to August 16, 2018 if EMIR Refit enters into force after the expiry of the existing exemption so as to prevent a gap between the two exemptions periods, providing legal certainty for PSAs and their counterparties.

The U.K. FCA issued a statement on August 8, 2018 supporting ESMA's new statement. The FCA confirmed that it will not require PSAs and their counterparties to put processes in place to trade their OTC derivatives on trading venues during the interim gap.

ESMA's statement is available at: <https://www.esma.europa.eu/press-news/esma-news/esma-issues-clarifications-clearing-obligation-and-trading-obligation-pension> and the FCA's statement is available at: <https://www.fca.org.uk/markets/emir>.

Global Bodies Consult on Incentives to Centrally Clear OTC Derivatives

On August 7, 2018, a consultation paper on incentives to centrally clear OTC derivatives was jointly published by the Financial Stability Board, the International Organization of Securities Commissions, the Basel Committee on Banking Supervision and the Committee on Payments and Market Infrastructures. The paper is part of the FSB's post-implementation evaluation of the effects of the G20 financial regulatory reforms. The consultation paper sets out the results of an evaluation of the reforms that have been implemented to incentivize central clearing of OTC derivatives, including mandatory clearing requirements, capital, liquidity and margin requirements, as well as the reforms to CCP resilience, recovery and resolution. The evaluation found that:

- I. the changes observed in OTC derivatives markets are consistent with the G20 Leaders' objective of promoting central clearing as part of mitigating systemic risk and making derivatives markets safer.
- II. the relevant post-crisis reforms, in particular the capital, margin and clearing reforms, taken together, appear to create an overall incentive, at least for dealers and larger and more active clients, to centrally clear OTC derivatives.
- III. non-regulatory factors, such as market liquidity, counterparty credit risk management and netting efficiencies, are also important and can interact with regulatory factors to affect incentives to centrally clear.
- IV. some categories of clients have less strong incentives to use central clearing, and may have a lower degree of access to central clearing.
- V. the provision of client clearing services is concentrated in a relatively small number of bank-affiliated clearing firms.
- VI. some aspects of regulatory reform may not incentivize provision of client clearing services.

Feedback to the consultation paper is invited until September 7, 2018. The final report, which will be published in November 2018, is intended to assist jurisdictions in determining whether any policy changes are necessary to their implementation of the G20 reforms for the OTC derivatives markets, taking into account the objectives of the G20 reforms.

The consultation paper is available at: <http://www.fsb.org/wp-content/uploads/P070818.pdf>.

FinTech

Regulators Unveil Plans to Launch Global Financial Innovation Network

On August 7, 2018, twelve international financial regulators and related organizations announced the launch of the Global Financial Innovation Network. The announcement, which was accompanied by a consultation paper on the role and objectives of the GFIN, serves as part two of a whitepaper published earlier this year by the U.K. Financial Conduct Authority on the possibility of forming a "global sandbox." The GFIN, as

proposed, would consist of three components: (i) information sharing and collaboration through a network of regulators; (ii) joint policy work and regulatory trials; and (iii) cross-border firm trials.

Current GFIN membership includes the following regulators and organizations:

- I. Abu Dhabi Global Market (ADGM, U.A.E.)
- II. Autorité des marchés financiers (AMF, Canada)
- III. Australian Securities & Investments Commission (ASIC, Australia)
- IV. Central Bank of Bahrain (CBB, Bahrain)
- V. Consumer Financial Protection Bureau (CFPB, U.S.)
- VI. Dubai Financial Services Authority (DFSA, U.A.E.)
- VII. Financial Conduct Authority (FCA, U.K.)
- VIII. Guernsey Financial Services Commission (GFSC, Guernsey)
- IX. Hong Kong Monetary Authority (HKMA, Hong Kong)
- X. Monetary Authority of Singapore (MAS, Singapore)
- XI. Ontario Securities Commission (OSC, Canada)
- XII. Consultative Group to Assist the Poor (CGAP, World Bank)

The GFIN hopes to build upon existing information sharing agreements to allow information sharing to take place on a larger and quicker scale, which would allow regulators to fill information gaps related to innovation, technological trends and emerging issues. This would help FinTech firms navigate international regulations by providing a comprehensive forum through which to interact with multiple regulators.

In addition, the GFIN aims to provide a space to encourage joint policy work and address areas of divergence between financial services regulators, particularly with respect to emerging technologies and legacy business models and regulatory frameworks.

As envisioned, the GFIN would also facilitate cross-border trials of emerging technologies across global jurisdictions.

The GFIN invites feedback on a set of ten questions presented in the consultation paper, including the proposed mission statement, functions, priorities and potential challenges with respect to implementation. All feedback is to be submitted to the working group no later than October 14, 2018.

The announcement is available at: <https://www.fca.org.uk/publications/consultation-papers/global-financial-innovation-network> and the consultation paper is available at: <https://www.fca.org.uk/publication/consultation/gfin-consultation-document.pdf>.

Recovery & Resolution

International Swaps and Derivatives Association Publishes ISDA 2018 US Resolution Stay Protocol to Facilitate Compliance With US Stay Regulations

On July 31, 2018, the International Swaps and Derivatives Association published the ISDA 2018 U.S. Resolution Stay Protocol. The protocol was developed to facilitate compliance with regulations issued by the Federal Reserve, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency that require global systemically important banking organizations to include contractual stays on early termination rights within in-scope qualified financial contracts, including swaps and repurchase agreements.

Adherence to the protocol will allow covered entities to comply with the U.S. stay regulations by amending in-scope QFCs to ensure that they are consistent with the limits on counterparties' exercise of default rights under Title II of Dodd-Frank and the Federal Deposit Insurance Act. The protocol will also limit counterparties' ability to exercise cross-default rights based on the insolvency or resolution of an affiliate of a covered entity.

ISDA members and non-members may adhere to the protocol beginning from the second half of August 2018. ISDA also announced it would also publish frequently asked questions to provide market participants with additional background information on the protocol and the U.S. stay regulations.

The first compliance date for the U.S. stay regulations is January 1, 2019.

The protocol is available at: <https://www.isda.org/2018/07/31/isda-2018-u-s-resolution-stay-protocol/> and ISDA's press release is available at: <https://www.isda.org/2018/07/31/isda-2018-u-s-resolution-stay-protocol/>. You may like to see Shearman & Sterling's client alert regarding the U.S. stay regulations is available at: <https://www.shearman.com/perspectives/2017/11/final-rule-issued-on-qualified-financial>.

Securities

EU Implementing Regulations for Benchmark Regulation Published

On August 9, 2018, two Commission Implementing Regulations supplementing the Benchmark Regulation were published in the Official Journal of the European Union. The Benchmark Regulation, which took effect across the EU in January 2018, sets out the authorization and registration requirements for benchmark administrators, including third-country entities, and the requirements for governance and control of administrators. It provides for different categories of benchmarks depending on the risks involved, imposes additional requirements on benchmarks considered to be "critical" and gives powers to national regulators to mandate, under certain conditions, contributions to or the administration of critical benchmarks.

The first Implementing Regulation provides for Implementing Technical Standards on the procedures and forms for the provision of information by national regulators to ESMA.

The second Implementing Regulation provides for ITS on a template for compliance statements to be used by an administrator of benchmarks where it has chosen not to apply some of the provisions of the Benchmark Regulation.

Both of the Implementing Regulations will be directly applicable across the EU, applying from October 29, 2018.

The ITS on information provided by national regulators to ESMA are available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1534508328066&uri=CELEX:32018R1105> and the ITS on templates for compliance statements are available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1534508280327&uri=CELEX:32018R1106>.

Upcoming Priorities for the Global FX Code

On August 6, 2018, the Global Foreign Exchange Committee published a paper entitled: "The FX Global Code at One Year: a Look Back and a Look Ahead." The FX Global Code was published by the GFXC in May 2017. It superseded and substantively updated existing guidance for participants in FX markets previously provided by the Non-investment Products (NIPs) Code. The Code comprises a set of global principles of good practice for the FX market, covering a broad range of areas, including ethics, governance, execution, information-sharing, risk management, compliance, trade confirmation and settlement.

The paper discusses the achievements of the GFXC and the way in which the Code has been received by market participants over the past year. These include increased awareness of and commitment to the Code, further integration of the Code into the business practices of FX market participants and evolution of the Code with changes in the FX market, in particular for transparency and disclosure.

The GFXC's upcoming priorities are outlined in the paper. These include:

- I. continuing the existing GFXC working groups - the disclosures working group and the cover and deal working group; and
- II. establishing two new GFXC working groups - one on buy-side outreach and the other to further integration of the Code.

The paper is available at: https://www.globalfxc.org/docs/fx_code_one_year.pdf.

Upcoming Events

September 4, 2018: EBA public hearing on its consultation on draft RTS for calculation of KIRB for securitized exposures

September 4, 2018: EBA public hearing on its consultation on draft Guidelines on outsourcing arrangements

September 4-5, 2018: OECD blockchain conference: Unleashing the potential and facing the challenges of blockchain (registration closes August 30, 2018)

September 11, 2018: FCA annual public meeting at which the FCA's 2017/2018 Annual Report will be discussed

October 15, 2018: SRB Conference 2018 - 10 years after the crisis: are banks now resolvable?

November 28, 2018: EBA 7th Annual Research Workshop - Reaping the benefits of an integrated EU banking market

Upcoming Consultation Deadlines

August 20, 2018: FSB call for feedback on the technical implementation of the TLAC Standard

August 20, 2018: FSB consultation on a draft cyber lexicon

August 22, 2018: PRA consultation on Securitization: the new EU framework and significant risk transfer

August 24, 2018: U.K. CMA consultation on proposed remedies to adverse competition in the investment consultancy and fiduciary management markets

August 30, 2018: ESMA consultation on extending the exemption from the clearing obligation for intragroup transactions with third country group entities

September 3, 2018: PSR discussion paper on use of data in the payments industry

September 4, 2018: CFTC's proposed amendments to SRO surveillance programs for FCMs

September 7, 2018: FMSB consultation on a draft statement of good practice on algorithmic trading

September 7, 2018: ESMA consultation on amendments to the MiFID II tick size regime

September 7, 2018: FSB, IOSCO, Basel Committee and CPMI consultation on incentives to centrally clear OTC derivatives

September 17, 2018: Comment deadline for Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (proposed changes to the Volcker Rule)

September 17, 2018: U.K. BEIS consultation on a draft Bill introducing a register of the beneficial owners for overseas legal entities that own U.K. property

September 19, 2018: EBA consultation on draft RTS for calculation of KIRB for securitized exposures

September 21, 2018: FCA interim report (MS 17/1.2) on its investment platform market study

September 24, 2018: EBA consultation on draft Guidelines on outsourcing arrangements

September 25, 2018: PRA consultation on reflecting the Systemic Risk Buffer framework within the Leverage Ratio framework for U.K. systemic ring-fenced bodies

September 26, 2018: ESMA consultation on revised Guidelines for periodic reporting by credit rating agencies

September 28, 2018: FCA call for input on the PRIIPs Regulation

September 30, 2018: BoE consultation on term SONIA reference rates

October 5, 2018: ESMA consultation on minimum information content of exempted documents under the Prospectus Regulation

October 5, 2018: ESMA consultation on draft guidelines on risk factors under the Prospectus Regulation

October 5, 2018: BoE/PRA/FCA Discussion Paper on operational resilience of firms and FMIs

October 5, 2018: FCA consultation on a new workers directory

October 5, 2018: Law Commission consultation on reform of the anti-money laundering regime for England and Wales

October 12, 2018: ISDA consultation on fall backs based on overnight risk-free rates for certain derivatives

October 27, 2018: FCA consultation on proposed changes to the rules governing P2P platforms

November 2, 2018: FCA discussion paper on the potential introduction of a new duty of care for financial services firms

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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