

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

Proposed Enhancements to the European Banking Authority's Powers for Anti-Money Laundering

On September 12, 2018, the European Commission published a Communication setting out a broad strategy for strengthening the EU's framework for anti-money laundering supervision. The Communication is accompanied by a fact sheet setting out Questions and Answers on the strategy.

The Commission notes that, despite the recent strengthening of the EU's framework through the Fourth Money Laundering Directive (4MLD) and the forthcoming Fifth Money Laundering Directive (5MLD), there are concerns that gaps remain in the EU's supervisory framework. The Commission highlights that there is no clear articulation between the prudential and anti-money laundering rules for financial institutions. It identifies shortcomings in the reaction time of national supervisors and in the level of cooperation and information sharing both between prudential and anti-money laundering supervisors and on a cross-border basis between EU supervisors and other supervisors based both within and outside the EU. While the Commission recognizes that 5MLD will remove certain obstacles to cooperation between anti-money laundering and prudential supervisors, it also notes that further steps are necessary to ensure effective supervisory cooperation, especially where financial institutions operate across borders.

In the Communication, the Commission sets out a strategy that has been developed following analysis carried out by a Joint Working Group convened by the Commission. The strategy includes short-term legislative and non-legislative initiatives, along with long-term objectives, to enhance interaction between the anti-money laundering and prudential frameworks.

The Commission proposes a number of legislative and non-legislative measures including the following:

- The Commission proposes an amendment to its September 2017 proposals to amend the founding regulations of the European Supervisory Authorities. The amendment is designed to: (i) centralize within the European Banking Authority the anti-money laundering resources and expertise that are currently spread across the three ESAs and the Joint Committee's dedicated subcommittee; (ii) specify in more detail in the EBA's founding regulation the anti-money laundering related tasks with which it is entrusted; (iii) reinforce the tools at the EBA's disposal for carrying out the anti-money laundering related tasks; and (iv) strengthen the coordination role of the EBA for international anti-money laundering related issues, in particular coordinating cooperation with relevant third-country authorities in cases entailing a cross-border dimension.
- The Commission notes that, in June 2018, the European Parliament tabled proposed amendments to the Commission's proposed amendments to the Capital Requirements Regulation and the Capital Requirements Directive (referred to as the CRDV package). The Commission supports the European Parliament's proposals, which relate to information exchange and the duty of cooperation between prudential and anti-money laundering authorities and bodies.
- The Commission invites the EBA to undertake a stock-taking exercise to identify the various anti-money laundering issues relevant from a prudential perspective and conduct a mapping exercise showing how anti-money laundering aspects are currently factored into prudential supervision. The EBA is then invited to adopt common guidance for EU prudential supervisors on how to appropriately and consistently take money-laundering and terrorist financing risks into account in their activities.
- The EBA is invited to analyze the impact of the different approaches behind the distribution of competences in prudential supervision and anti-money laundering supervision.

- The EBA is invited to monitor, in conjunction with the other ESAs, the implementation of the Risk-Based Supervision Joint Guidelines published in April 2017. The Commission also asks the ESAs to expand the Joint Guidelines to specify common procedures and methodologies for the supervision and assessment by anti-money laundering authorities of financial institutions' compliance with anti-money laundering rules.
- Going forward, the EBA should undertake reviews of the activities of EU anti-money laundering authorities, and make concrete recommendations to these authorities and have in place an effective follow-up mechanism.
- The EBA is invited to devise a cooperation strategy with relevant third-country authorities, for the purposes of enhancing international cooperation on anti-money laundering issues.

The Communication is available at: <http://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-645-F1-EN-MAIN-PART-1.PDF>, the fact sheet is available at: http://europa.eu/rapid/press-release_MEMO-18-5725_en.htm, the amended proposal on ESAs' powers are available at: <http://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-646-F1-EN-MAIN-PART-1.PDF>, details of the Commission's September 2017 proposals on ESA powers are available at: <http://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-646-F1-EN-MAIN-PART-1.PDF>, details of 5MLD are available at: <https://finreg.shearman.com/eu39s-fifth-money-laundering-directive-to-enter-i> and the Risk-Based Supervision Joint Guidelines are available at: https://esas-joint-committee.europa.eu/Publications/Guidelines/Joint%20Guidelines%20on%20risk-based%20supervision_EN%20%28ESAs%202016%2072%29.pdf.

Bank Prudential Regulation & Regulatory Capital

European Central Bank Consults on Part 2 to Guide to Licensing Credit Institutions

On September 14, 2018, the European Central Bank opened a consultation on a draft Part 2 to its Guide to Assessments of Licence Applications by banks. The ECB published the Guide to Assessment of Licence Applications in March 2018, which applies to all license applications to become a credit institution within the meaning of the CRR. The ECB developed the Guide, which is not legally binding, to promote awareness and enhance the transparency of the assessment criteria and processes for establishing a credit institution within the Single Supervisory Mechanism.

The consultation on the draft Part 2 of the Guide focuses on assessment criteria for capital requirements and business plans, including initial capital, own funds, location, operations and structural organization, banking group and outsourcing.

The consultation closes on October 25, 2018.

The consultation paper is available at:

https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/licence_applications_part2/ssm.draft_guide_201809.en.pdf?b370a4ec6f586938767bab4bf5e321d8, the consultation webpage is available at: https://www.bankingsupervision.europa.eu/legalframework/publiccons/html/licence_applications_part2.en.html and details of the Guide to Assessments of Licence Applications are available at: <https://finreg.shearman.com/european-central-bank-issues-final-guides-on-lice>.

UK Prudential Regulator Consults on Revisions to Supervisory Reporting Requirements

On September 12, 2018, the U.K. Prudential Regulation Authority launched a consultation on changes to the PRA's reporting requirements to reflect proposed changes set out by the EBA in consultations launched in August 2018. The EBA proposes a number of revisions to the existing Implementing Technical Standards on

the supervisory reporting requirements under the CRR. These include proposed revisions to the financial reporting (FINREP) annexes of the ITS, which add new reporting requirements for non-performing and forborne exposures, amend the reporting of profit or loss items (in particular on expenses) and amend the reporting on leases following International Financial Reporting Standard 16. Proposed revisions to the common reporting (COREP) annexes relate to the Liquidity Coverage Requirement for credit institutions.

The PRA's proposals are relevant to U.K. banks and building societies. Alignment of the PRA's reporting requirements requires the PRA to make amendments to PRA reporting templates for ring-fenced banks, profit and loss statements and forecast capital data and also requires an extension of the existing FINREP templates to include the non-performing loan and forborne exposure templates contained in the EBA's consultations.

Comments on the consultation are invited by December 12, 2018. The PRA's proposals will be implemented on a date that corresponds with the implementation of the EBA's FINREP and COREP changes. This is currently expected to be March 2020.

The consultation paper (PRA CP 19/18) is available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/consultation-paper/2018/cp1918.pdf>, the consultation webpage is available at: https://www.bankofengland.co.uk/prudential-regulation/publication/2018/regulatory-reporting-eba-taxonomy-29?utm_source=Bank+of+England+updates&utm_campaign=aefabc65d5-EMAIL_CAMPAIGN_2018_09_12_08_10&utm_medium=email&utm_term=0_556dbefcdc-aefabc65d5-113447021, details of EBA's proposals for the FINREP framework are available at: <https://finreg.shearman.com/european-banking-authority-proposes-revised> and details of the EBA's proposals for the COREP framework are available at: <https://finreg.shearman.com/european-banking-authority-proposes-revised-super>.

Brexit for Financial Services

UK Regulator Publishes Application Requirements for EEA Market Operators Seeking Recognition

On September 14, 2018, the Financial Conduct Authority published a direction on how EEA market operators can apply for recognition as an overseas investment exchange in preparation for Brexit. EEA market operators operating a regulated market, a multilateral trading facility or an organised trading facility currently use passports granted under the revised Markets in Financial Instruments Directive to give their U.K.-based members access to their markets. Once the U.K. has left the EU, those passports will no longer be valid and the U.K. Government does not intend to establish a temporary permissions regime in the event of a "no deal" outcome to the EU-U.K. Brexit negotiations or without an agreed implementation period. EEA market operators that engage in regulated activities when providing their U.K. members with access to their markets will need to apply for ROIE status, unless they can rely on the U.K.'s overseas persons exclusion. The FCA's direction sets out the FCA's expectations for EEA market operators.

The FCA's statement is available at: <https://www.fca.org.uk/news/statements/our-approach-overseas-market-operators-seeking-apply-become-recognised-overseas-investment-exchange> and the FCA's Direction is available at: <https://www.fca.org.uk/publication/handbook/roie-direction.pdf>.

FinTech

US and Singaporean Regulators Sign FinTech Collaboration Agreement

On September 13, 2018, the U.S. Commodity Futures Trading Commission and the Monetary Authority of Singapore signed a cooperation arrangement on FinTech innovation, which is to be supported by the agencies' respective FinTech initiatives, LabCFTC and the MAS Financial Technology & Innovation Group. The arrangement will facilitate inter-agency cooperation on FinTech innovation and referrals for innovators that wish to enter the other regulator's market. In addition, it will provide an information sharing framework between the agencies focused on FinTech market trends and developments, innovations and best practices within their respective jurisdictions. The arrangement also calls for joint events, proofs of concept, trials and innovation competitions where permitted, along with periodic meetings to discuss FinTech issues of common interest.

CFTC Chairman J. Christopher Giancarlo in a statement said that he believes this collaboration with the MAS will "enhance global awareness of the critical role of regulators in 21st century digital markets," while Ravi Menon, Managing Director of the MAS, said that he hopes the arrangement will "create more opportunities for firms in both jurisdictions, especially in developing innovative business models for the derivatives market."

The arrangement follows a similar agreement reached by the CFTC and the U.K. FCA this past February, and reflects the global nature of FinTech markets and the importance of cross-border collaboration between regulators.

The cooperation agreement is available at: <https://www.cftc.gov/sites/default/files/2018-09/cftc-mas-cooparrgt091318.pdf> and the CFTC/FCA agreement is available at: <https://fintech.shearman.com/cftc-and-fca-agree-to-collaborate-on-regulating-fintech-innovation>.

Recovery & Resolution

UK Government Consults on Transposition Measures for the EU Bank Creditor Hierarchy Directive

On September 12, 2018, HM Treasury published a consultation on the U.K. Government's proposed approach to implementing the EU Bank Creditor Hierarchy Directive (also known as the Insolvency Hierarchy Directive) into U.K. domestic law. Member states are required to transpose the BCHD into national law by December 29, 2018 and must apply the laws from the date of transposition.

The BCHD is part of a package of reforms aimed at further strengthening the resilience of EU banks. It lays down harmonized rules for the insolvency ranking of unsecured debt instruments for the purposes of the EU recovery and resolution framework. The BCHD introduces statutory subordination across the EU, by amending the Bank Recovery and Resolution Directive so as to require Member States to create a new class of non-preferred senior debt in their creditor hierarchy. Instruments meeting the relevant criteria to fall within the new class will be eligible to meet subordination requirements under the provisions of the Total Loss Absorbing Capacity (TLAC) term sheet and its EU equivalent, the requirement for Minimum Requirement for Own Funds and Eligible Liabilities (MREL). HM Treasury explains in the consultation paper that the statutory subordination introduced by the BCHD will not prevent the U.K.'s preferred approach, which is to require structural subordination (i.e. subordination within the terms of capital instruments).

The BCHD requires the new non-preferred senior class of debt to be provided for in normal insolvency proceedings. In the U.K., these proceedings are governed primarily by the Insolvency Act 1986, which, along with related legislation, was amended to transpose certain provisions of the BRRD. HM Treasury is proposing to make similar amendments to transpose the provisions of the BCHD. Non-preferential debt was not previously divided into classes, so the government proposes to sub-divide non-preferential debt into three classes: (i) "ordinary non-preferential debt," which will correspond with the non-preferential debt in the current regime; (ii) "secondary non-preferential debt," which will be the new class required by the BCHD and

rank below ordinary non-preferential debt; and (iii) additional Tier 1 and Tier 2 instruments and subordinated debt will rank below both ordinary and secondary non-preferential debt.

The proposed amendments to the Insolvency Act 1986 are contained in a draft of the Banks and Building Societies (Priorities on Insolvency) Order 2018. HM Treasury seeks feedback on the general approach and on its potential impacts by October 10, 2018.

The Directive is available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017L2399&from=EN>, the consultation webpage is available at: <https://www.gov.uk/government/consultations/draft-banks-and-building-societies-priorities-on-insolvency-order-2018-technical-consultation/technical-consultation-on-the-draft-banks-and-building-societies-priorities-on-insolvency-order-2018> and the draft Order is available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/739481/Draft_The_Banks_and_Building_Societies_Priorities_on_Insolvency_Order_2018.pdf.

Securities

EU Delegated Regulation on Settlement Discipline Published

On September 13, 2018, a Commission Delegated Regulation on settlement discipline was published in the Official Journal of the European Union. The Delegated Regulation sets out Regulatory Technical Standards on settlement discipline as required under the Central Securities Depository Regulation. The RTS cover measures for preventing settlement fails through automated matching, a hold and release mechanism and partial settlement. The RTS also provide measures for monitoring and addressing settlement fails, such as a mechanism for cash penalties and a buy-in process. The RTS will apply directly across the EU from September 14, 2020.

The RTS is available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R1229&from=EN>.

Working Group Recommends Replacement of EONIA With New Euro Short-Term Rate

On September 13, 2018, the European Central Bank announced its recommendation of the Euro short-term rate - ESTER - as a euro risk-free rate by a private sector working group. The group also recommends that ESTER replaces the Euro overnight index average, EONIA, because EONIA no longer complies with the EU Benchmark Regulation and will be restricted from January 1, 2020. The recommendations of the working group are not legally binding.

According to the ECB, ESTER will also provide a basis for developing fallbacks for contracts referencing the EURIBOR because the reformed ESTER methodology will be assessed for compliance with the Benchmark Regulation in 2019. ESTER reflects wholesale Euro unsecured overnight borrowing costs of Euro area banks and will be produced by ECB by October 2019, at the latest.

The European Money Markets Institute announced the termination of the Repo Index Project on September 10, 2018. The EMMI is the administrator of both EONIA and EURIBOR and intends to focus on the transition of EONIA to the new rate and on reforming EURIBOR's methodology.

The press release is available at: <https://www.ecb.europa.eu/press/pr/date/2018/html/ecb.pr180913.en.html>, further details on the development of ESTER are available at: <https://www.ecb.europa.eu/press/pr/date/2018/html/ecb.pr180628.en.html> and EMMI's announcement is

available at: <https://www.emmi-benchmarks.eu/assets/files/D0287A-2018%20-%20Communication%20on%20Termination%20of%20Repo%20Index%20Project.pdf>.

People

Bank of England Governor to Stay on Until Brexit

On September 11, 2018, HM Treasury published a press release announcing that Bank of England Governor Mark Carney will remain in his position for an extended term until January 31, 2020. The extension of Dr. Carney's term will ensure continuity at the BoE until Brexit is completed. A new governor would be appointed during Autumn 2019 after the terms for the U.K.'s withdrawal and the framework for the future U.K.-EU partnership have been agreed.

Sir Jon Cunliffe, BoE Deputy Governor with responsibility for financial stability, has also been re-appointed for a term from November 1, 2018 to October 2023.

The HM Treasury press release is available at: <https://www.gov.uk/government/news/mark-carneys-term-extended-and-sir-jon-cunliffe-re-appointed-at-the-bank-of-england> and the correspondence between Dr. Carney and the Chancellor of the Exchequer is available: <https://www.gov.uk/government/publications/bank-of-england-governor-extends-term-to-january-2020>.

Upcoming Events

September 27–28, 2018: Annual ESRB conference

September 28, 2018: BoE conference on Non-Bank financial institutions and financial stability (BoE in partnership with the CEPR, the Brevan-Howard Centre and the Paul Woolley Centre)

October 3, 2018: Public hearing on the EBA's consultation on revised ITS for supervisory reporting under the CRR

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

October 10, 2018: Public hearing on the EBA's consultation on revised ITS on supervisory reporting in line with the Liquidity Coverage Requirement under the Capital Requirements Regulation

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

Upcoming Consultation Deadlines

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 27, 2018: CPMI and IOSCO consultation on governance arrangements for OTC derivatives data elements

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

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

- October 1, 2018: Comment deadline for interim final rule regarding the treatment of certain municipal obligations as high-quality liquid assets under the liquidity coverage ratio rule
- 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 10, 2018: HMT consultation on transposition of the Bank Creditor Hierarchy Directive
- October 12, 2018: ISDA consultation on fall backs based on overnight risk-free rates for certain derivatives
- October 14, 2018: Regulators (globally) consultation on a Global Financial Innovation Network
- October 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)
- October 25, 2018: ECB consultation on draft Part 2 of the Guide to Assessments of Licence Applications by credit institutions
- October 26, 2018: EBA consultation on revised ITS on supervisory reporting in line with the Liquidity Coverage Requirement under the Capital Requirements Regulation
- October 27, 2018: FCA consultation on proposed changes to the rules governing P2P platforms
- October 29, 2018: Comment deadline for interim final rule regarding expanded 18-month examination cycle for certain small insured depository institutions and U.S. branches and agencies of foreign banks
- November 2, 2018: FCA discussion paper on the potential introduction of a new duty of care for financial services firms
- November 27, 2018: EBA consultation on revised ITS for supervisory reporting under the CRR
- December 12, 2018: PRA consultation on revisions to supervisory 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 FOLLOWING:

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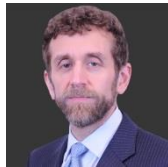
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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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