SHEARMAN & STERLING LLP

FINANCIAL INSTITUTIONS ADVISORY & FINANCIAL REGULATORY GROUP NEWSLETTER

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Financial Regulatory Developments Focus

In this newsletter, we provide a snapshot of the principal US, European and global financial regulatory developments of interest to banks, investment firms, broker-dealers, market infrastructure providers, asset managers and corporates.

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

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

Bank Prudential Regulation & Regulatory Capital

US Board of Governors of the Federal Reserve System Issues Proposed Rules Applying Enhanced Capital and Prudential Standards to Certain Insurance Companies

On June 3, 2016, the US Board of Governors of the Federal Reserve System issued proposed rules to apply enhanced prudential standards and capital standards to certain insurance companies within the Federal Reserve Board's jurisdiction. Specifically, the Federal Reserve Board issued an advance notice of proposed rulemaking that would apply capital standards to (i) systemically important insurance companies and (ii) insurance companies that own a bank or thrift. The ANPR would apply different capital standards to the two groups, but both approaches would be tailored to the differences between insurance companies and banks and would use insurance-focused risk weights and formulas that reflect the particular risks and liabilities faced by insurance companies.

The Federal Reserve Board concurrently approved a proposed rule to apply enhanced prudential standards to insurance companies designated as "systemically important" by the US Financial Stability Oversight Council. Under the proposed rule, a systemically important insurance company would be subject to the requirements applicable to systemically important financial institutions set forth under the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requirements would apply heightened liquidity, corporate governance and risk-management standards to the firms.

Federal Reserve Board Chair Janet Yellen and Federal Reserve Board Governor Daniel Tarullo issued separate statements discussing the proposals, stating that the ANPR and the proposed rules for insurance companies would serve the purpose of applying more stringent regulation to firms that pose greater risks to the financial system, while at the same time creating tailored regulation that reflects the individual characteristics of financial institutions.

Comments on the ANPR and the proposed rule are due by August 2, 2016.

The full text of the ANPR is available at: http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20160603a1.pdf.

The full text of the proposed rule is available at: http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20160603a2.pdf.

The text of Chair Yellen's statement is available at: http://www.federalreserve.gov/newsevents/press/bcreg/yellen-opening-statement-20160603.htm.

The text of Governor Tarullo's statement is available at: http://www.federalreserve.gov/newsevents/press/bcreg/tarullo-opening-statement-20160603.htm.

US Board of Governors of the Federal Reserve System Announces Date of Release for Results of Supervisory Stress Tests and the Comprehensive Capital Analysis and Review

On June 2, 2016, the Federal Reserve Board announced that it would release results from the latest supervisory stress tests on Thursday, June 23, 2016. Results from the Comprehensive Capital Analysis and Review will be released on Wednesday, June 29, 2016. The stress tests, conducted pursuant to requirements in the Dodd-Frank Act, and the CCAR exercises aim to help large bank holding companies assess the sufficiency of their capital and capital planning processes, taking into account the unique risks of the institutions and the companies' risk measurement and risk management procedures.

The Federal Reserve Board's press release regarding the stress testing and CCAR results is available at: http://www.federalreserve.gov/newsevents/press/bcreg/20160602a.htm.

Final EU Legislation on Exclusion on the Application of Write-down or Conversion Powers Under the Bank Recovery and Resolution Directive

On June 1, 2016, a Commission Delegated Regulation further specifying the circumstances in which exclusion from the application of write-down or conversion powers is necessary under the Bank Recovery and Resolution Directive was

published in the Official Journal of the European Union. Under the BRRD, the bail-in tool may be applied to all liabilities unless they fall within the list of liabilities explicitly excluded. The new Regulation provides that regulators may only exclude a liability if the obstacles invoked for such exercise do not allow for it to take place within a reasonable time. The BRRD only allows regulators to exclude a liability from bail-in, if it considers that it is not possible to bail-in the liability within a "reasonable time," which is determined by assessing when the write-down amount ultimately has to be determined; and then assessing, the time by which all tasks needed to bail-in those liabilities would need to be performed in order to meet the resolution objectives. The new Regulation specifies that regulators may exclude liabilities on the basis of it being necessary and proportionate to preserve critical functions and core business lines under the BRRD. The Regulation will apply from June 21, 2016.

The delegated regulation is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.144.01.0011.01.ENG&toc=OJ:L:2016:144:TOC.

European Commission Consults on EU Implementation of the Net Stable Funding Ratio

On May 26, 2016, the European Commission published a consultation paper on the implementation of the Net Stable Funding Ratio at European Union level. The NSFR measures the assumed degree of stability of liabilities and the liquidity of assets over a one-year horizon. The Capital Requirements Regulation introduced reporting requirements for the NSFR without setting any more detailed requirements. The EBA published a report in December 2015 on whether, and how, it would be appropriate to ensure that institutions use stable sources of funding, supporting the Basel Committee NSFR at a European level but with some specificities regarding its calibration. To supplement the Commission's analysis of the EBA's report and Call for Evidence published in September 2015, the Commission is calling for a more nuanced treatment of specific business models and some transactions. The consultation seeks views on the treatment of specific aspects of the NSFR, derivative and short-term transactions (less than six months) with financial institutions and the application of the proportionality principle, in particular, the appropriate level of NSFR application and the criteria for defining institutions with a "low liquidity risk profile."

Responses to the consultation are due by June 24, 2016.

The consultation paper is available at: http://ec.europa.eu/finance/bank/docs/regcapital/crr-crd-review/20160526-nsfr-consultation_en.pdf.

The EBA report on NSFR is available at: https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-22+NSFR+Report.pdf.

European Commission Consults on Revisions to Capital Requirements Framework and EU Implementation of CRR

On May 26, 2016, the European Commission published a consultation paper on proposed options for implementing principles of proportionality in the upcoming capital requirements framework, to review the Original Exposure Method and replace the current standardized approached for counterparty credit risk with a new standardized approach. The consultation looks at the potential introduction of new standards for market risks in the prudential framework as it provides an opportunity to reassess the issue of proportionality for smaller or simpler financial institutions. The current risk framework contained in the CRR establishes some principles of proportionality but there is no derogation for small trading book businesses which would allow firms with non-significant trading activities to use a simplified prudential framework to calculate requirements for their trading exposures. The proposed Basel Committee for Banking Supervision standardized approach would bring significant modifications to the current approach in the CRR, making it more risk sensitive and better suited for complex financial instruments. The Commission is considering whether to implement a simplified version of the new standardized approach or to keep the current standardized approach.

The Commission is mandated to submit a report to the European Parliament by December 31, 2016, on the use of the Original Exposure Method under the CRR. The OEM is a standardized approach used to calculate the exposure values

of derivative contracts, but only firms that can benefit from the derogation for small trading book businesses can use it. Numerous limitations on the application of the OEM have been identified: in particular, its simple design renders it difficult accurately to capture the exposure value of derivative transactions. The Commission is proposing three options: (i) keep the OEM in its current form; (ii) modify it in order to ensure its consistency with the Standardized Approach for Counterparty Credit Risk; or (iii) remove it and replace it the with the Basel Committee Standardized Approach for Counterparty Credit Risk.

Responses to the consultation are due by June 24, 2016.

The consultation paper is available at: http://ec.europa.eu/finance/bank/docs/regcapital/crr-crd-review/20160526-trading-book-consultation_en.pdf.

Amendments to EU Technical Standards on Disclosure for Identification of G-SIIs

On May 25, 2016, a Commission Implementing Regulation which amends the Implementing Technical Standards on uniform formats and dates for the disclosure of values used to identify global systemically important institutions under the CRR was published in the Official Journal of the European Union. The ITS supplement CRR provisions that require regulators to identify G-SIIs, based upon the templates issued by the Basel Committee on Banking Standards. The amended ITS take into account revisions proposed by the European Banking Authority in January 2016. G-SIIs are now required to report the information used to identify G-SIIs (such as indicators, ancillary data and memorandum items) to the regulator in electronic format, using a template annexed to amending ITS. The amended ITS provides that G-SIIs publicly disclose the values of the indicators used for determining the score of G-SIIs in accordance with the Commission Delegated Regulation on the methodology for the identification of G-SIIs. Information required in the template includes general information such as bank name and reporting dates. The template will also include monetary values on indicators such as payments made in the reporting year, assets under custody and underwritten transaction in debt and equity markets. The amending ITS entered into force on May 26, 2016.

The amending ITS is available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.136.01.0004.01.ENG&toc=OJ:L:2016:136:TOC.

European Banking Authority Publishes Guidelines on Stress Tests of Deposits Guarantee Schemes

On May 24, 2016, the European Banking Authority published guidelines for upcoming stress tests of deposit guarantee schemes under the Deposit Guarantee Schemes Directive. The Directive introduced a number of measures to improve the resilience of deposit guarantee schemes in Europe and the EBA is required to perform stress tests every three years; the first is to take place by July 3, 2017. The purpose of the stress test is to verify whether the operation and funding capabilities of the DGS are sufficient to ensure deposit protection, within the conditions of the Directive, during times of increased pressure. The EBA has decided to produce guidelines for consistency across the European Union and to ensure that the stress test is a credible assessment tool.

The guidelines outline methodical principles that are intended to result in a systematic and comprehensive approach to planning, running and conducting stress test exercises. The guidelines elaborate on the type of intervention scenarios that should be simulated by DGSs, as set out in the Directive, such as repayment, contribution in resolution and support for failure prevention. The guidelines require DGSs should test a broad range of operational and funding capabilities. The tests should cover the main functions activated when a DGS intervenes, such as access to data, operational resources, repayment periods and ability to meet liabilities with the alternative funding means at its disposal. The stress tests are to be run on a comparable basis in terms of scenario and test areas, in order to provide context for comparison. Results of the stress test are to be published by the EBA at least every five years.

The guidelines will apply from two months after publication of the official EU language versions.

The EBA guidelines are available at: http://www.eba.europa.eu/documents/10180/1472555/EBA-GL-2016-04+%28Final+report+on+GL+on+DGS+stress+tests%29.pdf.

UK Finalizes its Systemic Risk Buffer Framework

On May 26, the Financial Policy Committee published the final UK framework for the Systemic Risk Buffer for ring-fenced banks and large building societies (i.e. those that will be subject to the UK ring-fencing rules from 2019 with assets over £25 billion). The SRB, a discretionary buffer under the EU Capital Requirements Directive, aims to mitigate and prevent long-term non-cyclical macro-prudential or systemic risk.

The SRB rate will be calibrated according to a firm's total Risk-Weighted Assets so that firms with RWA: (i) less than £175 billion will have a 0% SRB; (ii) between £175 and £320 billion will have a 1% SRB; (iii) between £320 and £465 billion will have a 1.5% SRB; (iv) between £465 and £610 billion will have a 2% SRB; (v) between £610 and £755 billion will have a 2.5% SRB; and (vi) over £755 billion will have a 3% SRB.

The Prudential Regulation Authority is responsible for implementing the SRB and will consult later this year on its proposals for this. The PRA must decide upon the basis of application of the SRB—individual, sub-consolidated or consolidated. In October 2015, the PRA consulted on implementation of the ring-fencing rules and proposed a sub-consolidated basis where a ring-fenced sub-group is in place. In addition to choosing the level of application, the PRA must apply the FPC's methodology and set a buffer rate. However, the regulator may exercise its judgment when setting the SRB rate for individual firms and may also waive the SRB. The FPC has recommended that the PRA ensures that there is sufficient capital within a consolidated group that includes a ring-fenced bank to address both global and domestic systemic risks.

The PRA will apply the SRB to individual firms from 2019, which is when the ring-fencing rules will become applicable. The PRA is expected to publish its policy statement, final rules and supervisory statements on the ring-fencing requirements by mid-2016.

Firms subject to the SRB will also be subject to a 3% minimum leverage ratio requirement as well as an additional leverage ratio buffer of 35% of the applicable SRB rate. The SRB is expected to add about 0.5% of RWAs to the equity requirements of UK systemic banks.

The FPC's SRB framework is available at:
http://www.bankofengland.co.uk/financialstability/Documents/fpc/srbf_cp260516.pdf.

Consumer Protection

US Consumer Financial Protection Bureau Proposes Rule Regulating "Pay Day Loan" Industry

On June 2, 2016, the US Consumer Financial Protection Bureau issued a lengthy proposed rule to regulate so-called "pay day loans." Specifically, the proposed rule would impose restrictions on "covered loans," defined as (i) loans with a term of 45 days or less and (ii) loans with a term greater than 45 days that (a) have an all-in annual percentage rate greater than 36% and (b) are either repaid directly from the consumer's account or income or are secured by the consumer's vehicle. For these covered loans, the proposed rules would deem it an abusive and unfair practice for a lender to make such a loan without "reasonably determining that the consumer has the ability to repay the loan." In addition, the proposal would restrict lenders of covered loans from making such loans when a consumer has, or recently has had, certain outstanding loans (in general, certain loans that the consumer has had difficulty repaying).

In a statement issued concurrently with the proposed rule, CFPB Director Richard Cordray stated that the proposed rule is aimed at mitigating concerns that consumers were being "set up to fail" with loan payments that they were unable to

repay, leading borrowers into a cycle of defaulting and re-borrowing, with the result being the inability of such consumers to afford other basic living expenses.

The text of the proposed CFPB rule is available at: http://files.consumerfinance.gov/f/documents/Rulemaking_Payday_Vehicle_Title_Certain_High-Cost_Installment_Loans.pdf.

The text of Director Cordray's statement is available at: http://www.consumerfinance.gov/about-us/newsroom/prepared-remarks-richard-cordray-director-consumer-financial-protection-bureau/.

UK Treasury Committee Requests Regulators to Consider Risks and Opportunities of Crowdfunding

On June 1, 2016, the Treasury Committee of the UK Parliament announced that Andrew Tyrie MP, Chairman of the Treasury Committee, had written to Financial Conduct Authority and the Prudential Regulation Authority requesting further information about the risks and opportunities presented by crowdfunding (also known as peer-to-peer lending). The letter to the FCA focuses on conduct risk and consumer protection and the letter to the PRA requests information about the resilience of crowdfunding platforms to economic stress.

The letter to the FCA is available at: http://www.parliament.uk/documents/commons-committees/treasury/01062016-Chairman-to%20FCA.pdf.

The letter to the PRA is available at: http://www.parliament.uk/documents/commons-committees/treasury/01062016-Chairman-to-PRA.pdf.

Derivatives

US Commodity Futures Trading Commission Announces Memorandum of Understanding with the European Securities and Markets Authority Regarding Recognized Central Counterparties

On June 6, 2016, the US Commodity Futures Trading Commission announced the signing of a Memorandum of Understanding with the European Securities and Markets Authority regarding cooperation with respect to recognized central counterparties. Pursuant to the MOU, derivatives clearing organizations established in the United States may apply to ESMA for recognition as central counterparties, known as "Recognized CCPs."

The text of the MOU is available at: http://www.cftc.gov/idc/groups/public/@internationalaffairs/documents/file/cftc-esma-clearingmou060216.pdf.

US Commodity Futures Trading Commission Issues Supplement Modifying Position Limits Proposal

On May 26, 2016, the CFTC issued for public comment a supplement to the CFTC's December 2013 position limits proposal. The supplement would permit exchanges to recognize, subject to CFTC review, certain positions in commodity derivative contracts as non-enumerated bona fide hedges or enumerated anticipatory bona fide hedges, as well as to exempt from federal position limits certain spread positions.

In a statement issued concurrently with the proposed rule, CFTC Chairman Timothy Massad noted that the proposed supplemental rule was a critical piece of the CFTC's effort to finalize rules on position limits in 2016.

CFTC Commissioner Christopher Giancarlo also voiced support for the proposal in a separate statement, stating his belief that the proposal reflects practical realities by recognizing that most exchanges do not have access to sufficient swap position information to effectively monitor swap position limits.

If adopted, the proposed supplement would relieve designated contract markets and swap execution facilities from setting and monitoring exchange limits on swaps until DCMs and SEFs have access to data that would enable them to do so.

The full text of the proposed supplemental rule is available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/federalregister052616.pdf.

The text of Chairman Massad's statement is available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement052616.

The text of Commissioner Giancarlo's statement is available at: http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement052616.

Financial Crime

US House of Representatives to Conduct Oversight Regarding Recent SWIFT Theft

On May 31, 2016, in a letter to the Federal Reserve Bank of New York, the US House of Representatives Committee on Science, Space and Technology announced that it will be conducing oversight over the recently discovered SWIFT cyber-attack which resulted in the theft of approximately $101 million from Bank of Bangladesh accounts at the New York Fed. The letter states that, in light of the recent cyber-attacks on global financial systems, the Committee believed it necessary to receive information from the New York Fed about its response, its oversight of SWIFT, the status of the investigation and any remedial steps taken to address vulnerabilities.

The full text of the letter is available at: https://science.house.gov/sites/republicans.science.house.gov/files/documents/05_31_2016%20SST%20-%20NY%20Fed.pdf.

US Financial Crimes Enforcement Network Identifies the Democratic People's Republic of Korea as a Jurisdiction of Primary Money Laundering Concern

On May 27, 2016, the US Financial Crimes Enforcement Network, pursuant to authority contained in the USA PATRIOT ACT, found "reasonable grounds" to conclude that the Democratic People's Republic of Korea is a jurisdiction of primary money laundering concern. In its notice, FinCEN cited several factors that contributed to this conclusion, including evidence that organized criminal groups, international terrorists or entities involved in the proliferation of weapons of mass destruction have transacted business in North Korea, evidence that North Korea has been found to have repeatedly failed to address the deficiencies in its AML regime and the extent to which North Korea has demonstrated high levels of institutional and official corruption.

Concurrent with this finding, FinCEN issued a notice of proposed rulemaking to propose a prohibition on covered financial institutions from opening or maintaining a correspondent account in the United States for or on behalf of a North Korean banking institution and to prohibit the use of foreign banking institutions' correspondent accounts at covered US financial institutions to process transactions involving North Korean financial institutions.

Written comments on the FinCEN proposed rule must be submitted by August 2, 2016.

The full text of the proposed rule is available at: https://www.gpo.gov/fdsys/pkg/FR-2016-06-03/pdf/2016-13037.pdf.

The full text of the FinCEN notice is available at: https://www.federalregister.gov/articles/2016/06/02/2016-13038/finding-that-the-democratic-peoples-republic-of-korea-is-a-jurisdiction-of-primary-money-laundering#h-16.

Financial Market Infrastructure

Bank of England Paper on Legal Framework for Central Counterparty Default Management Process

On May 11, 2016, the Bank of England published a Financial Stability Paper on legal certainty for central counterparty default management processes. In the context of legal certainty, the paper focuses on the ability of CCPs effectively to manage a large member default. The paper provides analysis of the three key stages in the process of managing a default

at a clearing house: (i) declaration of default; (ii) returning to a matched book; and (iii) managing collateral to absorb the losses caused by the default.

The paper examines the rules governing CCP default management and the extent to which they provide legal certainty. The current legal framework provides certainty around many aspects of financial markets which has been created through the interaction of contract and legislation at both UK and EU levels. Legislation such as the UK Companies Act 1989, European Market Infrastructure Regulation, Settlement Finality Regulation and the Financial Collateral Arrangements (No. 2) Regulation all provide protections but apply in different situations resulting in a patchwork of partial safe harbors. The Bank of England highlights various steps that could be taken to make this legislative framework more robust and coherent.

The Financial Stability Paper is available at: http://www.bankofengland.co.uk/financialstability/Documents/fpc/fspapers/fs_paper37.pdf.

Financial Services

US Securities and Exchange Commission Adopts Amendments to Form 10-K

On June 1, 2016, the US Securities and Exchange Commission approved a final rule, implementing a provision of the Fixing America's Surface Transportation Act, amending Form 10-K disclosure requirements. The interim final rule allows Form 10-K filers to provide a summary of business and financial information contained in the annual report, provided that the summary also contains hyperlinks to the more detailed disclosure in the form.

The SEC also requested comment on whether the interim rule should provide more guidance on the form and content of the summary as well as the applicability of the amended rule to other annual reporting forms.

Comments on the interim final rule must be received on or before 30 days after publication in the Federal Register.

The full text of the interim final rule is available at: http://www.sec.gov/rules/interim/2016/34-77969.pdf.

European Securities and Markets Authority Consults on Draft Technical Advice for the Benchmarks Regulation

On May 27, 2016, ESMA launched a consultation on its proposed technical advice to the European Commission on delegated acts due under the EU Benchmarks Regulation. ESMA consulted in February this year on its initial approach to the technical advice and the draft technical standards that it is required to prepare. The consultation on draft technical standards will be held separately in the second half of 2016. ESMA's advice will cover: (i) certain definitions, including the definition of benchmarks and "use;" (ii) criteria for the identification of critical benchmarks; (iii) endorsement of a benchmark or family of benchmarks provided in a third country; (iv) the measurement of the use of critical and significant benchmarks; and (v) transitional provisions.

The Benchmark Regulation has been adopted but has not yet been published in the Official Journal of the European Union. Once it is published, expected in June, it will come into force. ESMA's advice to the Commission is due within four months of the Benchmarks Regulation entering into force.

Responses to the consultation are to be received by June 30, 2016.

ESMA's consultation paper is available at: https://www.esma.europa.eu/press-news/esma-news/esma-consults-proposed-implementing-measures-benchmarks-regulation.

First Phase of Global FX Code Released

On May 26, 2016, the Bank for International Settlements published the Phase 1 materials for a global Code for the FX market. The Code is a set of principles providing common guidelines to promote the integrity and effectiveness of the global wholesale FX markets and has been prepared as a result of the recent spate of misconduct cases in the FX

markets. The Code covers governance, risk management and compliance, ethics, information sharing, execution and confirmation and settlement processes. The final Code is expected to be published in May 2017. In the meantime, the authors hope that market participants will begin to embed the Code into their day-to-day activities. The Code does not impose any legal or regulatory obligations on market participants and is intended to supplement local laws, rules and regulations by identifying global good practices and processes.

The FX Code is available at: https://www.bis.org/mktc/fxwg/gc_may16.pdf and the Update on Adherence to the Code is available at: https://www.bis.org/mktc/fxwg/am_may16.pdf.

UK Legislation Implementing Regulatory Powers for HM Treasury on Financial Collateral Arrangements

On May 23, 2016, an Order was published implementing provisions in the Banking Act 2009, providing powers to HM Treasury to make regulations about financial collateral arrangements. The relevant provisions come into force on May 25, 2016. Financial collateral arrangements are arrangements under which financial collateral is used as security in respect of a loan or other liability, such as cash and securities. The scope of regulation HM Treasury can make is not restricted purely to provisions required in order to implement the Financial Collateral Directive. This is presumably a prelude to restating the Financial Collateral Arrangements (No. 2) Regulations 2003 in light of recent Supreme Court decision, *The United States of America v Nolan*, expressing doubt as to its enforceability owing to such regulations arguably going beyond EU laws in some respect and therefore not being made validly under the European Communities Act 1972. The relevant provisions of the Banking Act provide that HM Treasury can make any provision it deems necessary or desirable for the purpose of enabling financial collateral arrangements, whether or not with an international element, to be commercially useful and effective. The regulations may, in particular, make provision for the enforcement of financial collateral arrangements, and include matters relating to the rule of law about formalities or evidence, insolvency, administration and receivership.

The Order is available at: http://www.legislation.gov.uk/uksi/2016/598/pdfs/uksi_20160598_en.pdf and the Supreme Court Decision is available at: https://www.supremecourt.uk/cases/docs/uksc-2014-0073-judgment.pdf.

FinTech

European Securities and Markets Authority Seeks Views on Distributed Ledger Technology

On June 2, 2016, ESMA published a discussion paper on how distributed ledger technology (including, for example, "blockchains") applies to the securities markets. ESMA is assessing the risks posed by DLT as well as the benefits and key challenges of DLT for securities markets. ESMA's paper provides an analysis of the applicable EU regulatory framework, focusing on legislation for post-trading activities, which include the European Market Infrastructure Regulation, the Settlement Finality Directive and the Central Securities Depositories Regulation.

Responses to the discussion paper are invited by September 2, 2016. ESMA will assess the feedback to develop its position on the use of DLT in the securities markets and to assess the need for a regulatory response.

The discussion paper is available at: https://www.esma.europa.eu/press-news/esma-news/esma-assesses-usefulness-distributed-ledger-technologies.

MiFID II

European Commission Adopts Technical Standards on Requirements for Data Reporting Services Providers Under MiFID II

On June 2, 2016, the European Commission adopted a Delegated Regulation on Regulatory Technical Standards on the authorization and organizational requirements for, and publication of transactions by, Data Reporting Services Providers. The revised Markets in Financial Instruments Directive will introduce requirements for DRSPs to be authorized and

supervised for their data reporting services, including the operation of Approved Publication Arrangements, Consolidated Tapes and Approved Reporting Mechanisms. The adopted RTS set out the requirements for authorization and ongoing supervision of DRSPs, including the provision of information to be provided to a national regulator when a DRSP is applying for authorization under MiFID II and the organizational requirements covering, amongst others, conflicts of interest, outsourcing, business continuity, IT security and connectivity. The adopted RTS also provide for the publication arrangements that a DRSP must have in place relating to machine readability, scope of data to be provided, non-discrimination and non-duplication.

The adopted RTS are subject to consideration by the European Parliament and the Council of the European Union. Once final, the adopted RTS will apply directly across the EU from the date that MiFID II applies.

The discussion paper is available at: https://www.esma.europa.eu/press-news/esma-news/esma-assesses-usefulness-distributed-ledger-technologies.

European Commission Adopts Technical Standards on Access to Information on Benchmarks Under MiFID II

On June 2, 2016, the European Commission adopted a Delegated Regulation on RTS setting out the standards for non-discriminatory access for central counterparties and trading venues to licenses of, and information relating to, benchmarks. The Markets in Financial Instruments Regulation provides for such access so as to allow for the determination by a CCP or trading venue of the value of certain financial instruments for trading and clearing purposes. The adopted RTS provide the list of information to be provided by a benchmark owner to a trading venue or CCP requesting access. The information requested must be necessary for the CCP or trading venue to perform its clearing or trading function. The adopted RTS provide that, for trading venues, those functions are, at least: (i) an initial assessment of the characteristic of the benchmark, (ii) the marketing of the relevant product and (iii) the support of the price information process for contracts admitted or being admitted to trading. For CCPs, the relevant functions are (i) risk management of relevant open positions in exchange-traded derivatives, including netting, and (ii) compliance with the requirements under the European Market Infrastructure Regulation. The adopted RTS also set out the price and data feed information to be provided as well as the composition, methodology and pricing information required to allow a CCP or trading venue to understand how each benchmark value is created and the actual benchmark values.

The information is to be provided to CCPs and trading venues through licensing on the same timescales and under the same conditions, unless different conditions are justifiable, according to conditions set by a benchmark owner. The conditions must include, amongst others, the scope of use and content of information, the conditions for redistribution and the governing law and allocation of liabilities.

The adopted RTS also establish the standards by which a benchmark will be judged to be new and therefore able to benefit from transitory arrangements.

The adopted RTS are subject to consideration by the European Parliament and the Council of the European Union. Once final, the adopted RTS will apply directly across the EU from January 3, 2019.

The adopted RTS is available at: http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-3203-EN-F1-1.PDF.

European Commission Adopts Technical Standards on Disaggregation of Pre- and Post-Trade Transparency Data Under MiFID II

On June 2, 2016, the European Commission adopted a Delegated Regulation on RTS which set out the requirements for trading venues to provide pre- and post-trade transparency data. MiFIR requires data to be publicly available in an unbundled format. The adopted RTS set out the level of disaggregation by which trading venues should offer data - by asset class, by country of issue, by the currency in which the financial instrument is traded and whether the data comes from scheduled daily auctions or continuous trading. Market operators and investment firms operating a trading venue should also offer any combination of disaggregation on a reasonable commercial basis on request and may offer bundles

of data. Where it is not possible to determine the asset class to which an instrument belongs unambiguously, market operators and investment firms operating a trading venue should determine which criteria the relevant financial instrument meets.

The adopted RTS are subject to consideration by the European Parliament and the Council of the European Union. Once final, the adopted RTS will apply directly across the EU from the date that MiFID II applies.

The adopted RTS is available at: http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-3206-EN-F1-1.PDF.

European Securities and Markets Authority Opines on MiFID II Ancillary Business Criteria

On May 30, 2016, ESMA published an Opinion specifying the criteria for establishing, under MiFID II, when the activity of a firm is to be considered "ancillary" to the main business of the firm at a group level. Under the current MiFID, eligible firms trading commodity derivatives can rely on exemptions for ancillary activities, avoiding the need to become regulated as an investment firm. MiFID II narrows the ancillary activity exemption considerably. ESMA is required to develop RTS to specify the criteria which must be taken into account for the revised exemption. They have specified at least the following two elements: (i) the need for ancillary activities to constitute a minority of activities at a group level; and (ii) the size of their ancillary trading activity compared to the overall market trading activity in that asset class. ESMA submitted draft RTS to the Commission on September 28, 2015. On March 14, 2016, the Commission indicated its intention to endorse the draft RTS, subject to a number of changes. In particular, the Commission requested that ESMA include, when proportionate and appropriate, a capital-based test for groups that have undertaken significant capital investments, relative to their size, in the creation of infrastructure, transportation or production facilities or groups that undertake activities or investments which cannot be hedged in financial instruments. The Opinion published is in response to the Commission's request.

ESMA has responded by stating its view that the proposed business activity test in its final draft RTS is in line with the objectives pursued by the exemption for ancillary activities contained in MiFID II. ESMA's view is that a capital-based test has drawbacks, because such a test could be inaccurate and could see a firm meeting requirements, or failing to meet requirements, depending on a given time period. Also, the different sizes and wide varieties of sectors and participants in commodity derivatives markets mean that such a test may fail to ensure a level playing field for market participants. Should the Commission decide to introduce a capital test, ESMA has identified some metrics that could be used by the Commission as an alternative to the main business test already designed by ESMA, such as the annual gross notional amount of transactions in commodity derivatives in the EU. ESMA has proposed that, if a capital test is introduced, entities should be able to choose between performing the original main business test based on trading activity or a capital test, on the basis that this would avoid putting small-and medium-sized entities at a disadvantage.

ESMA also published an amended version of the RTS with some minor changes not related to the Commission's request; for example, altering the date in the RTS to take into account the co-legislator's agreement to delay the implementation of MiFID II.

ESMA's opinion and amended RTS are available at: https://www.esma.europa.eu/press-news/esma-news/esma-issues-opinion-mifid-ii-standards-ancillary-activities.

European Commission Adopts Further Technical Standards Under MiFID II

On May 26, 2016, the European Commission adopted two Delegated Regulations with RTS which will supplement MiFID II and MiFIR. The first RTS, relevant to MiFIR, set out the criteria that ESMA must use to assess whether derivatives that have been declared subject to the clearing obligation (under the European Market Infrastructure Regulation) have sufficient third-party buying and selling interest to be considered sufficiently liquid for the trading obligation to apply. MiFIR will introduce a trading obligation, whereby standardised volumes of sufficiently liquid non-equity instruments must be traded on a regulated market, multilateral trading facility, organized trading facility or

equivalent third-country platform (and not OTC). This RTS aims at addressing the criteria for this to apply by expanding on the criteria set out in MiFIR as follows: (i) the average size and frequency of trades over a range of market conditions—ESMA must consider the number of days on which trades took place and the number of trades taking into account the distribution of trading executed on trading venues and executed OTC as well as consider the average daily turnover of trades and average value of trades; (ii) the number and type of active market participants—ESMA must consider whether there are more than two market participants trading in the class of derivatives, the number of trading venues that have admitted to trading or are trading the class of derivative and the number of market makers; and (iii) the average size of the spreads—ESMA must consider the average size of weighted spreads and the spreads at different points of time.

The second RTS, relevant to MiFID II, specify the criteria according to which a trading platform will be considered to be material in terms of liquidity. Such a trading platform must notify its national regulator when it imposes a temporary halt to trading of a relevant financial instrument. This means that only those trading platforms with the greatest potential for market-wide impact when a temporary halt to trading is instated will be subject to the notification obligation. For equity and equity-like financial instruments, the material market in terms of liquidity will be the trading venue in the EU that has the highest turnover in the relevant financial instrument. For non-equity financial instruments, the material market in terms of liquidity will be the regulated market where the relevant financial instrument was first admitted to trading. If the non-equity financial instrument is not admitted to trading on a regulated market, the material market in terms of liquidity will be the trading venue where it was first traded.

Both RTS will apply directly across the European Union from the same date that MiFID II applies. MiFID II is currently due to apply from January 3, 2017. However, draft legislation is likely to delay the application date for a year. The RTS are now subject to consideration by the European Parliament and the Council of the European Union.

The RTS on the criteria for determining the trading obligation is available at: http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2710-EN-F1-1.PDF and the RTS on temporary trading halts is available at: http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-3020-EN-F1-1.PDF.

Level Two Legislation Under MiFID II on Information to be Provided by MTFs and OTFs

On May 26, 2016, a Commission Implementing Regulation containing Implementing Technical Standards on the information to be provided to national regulators by investment firm and market operators of multilateral trading facilities and organized trading facilities was published in the Official Journal of the European Union. The ITS supplement the revised MiFID, setting out the information that the operator of a MTF or OTF will need to provide to its national regulator on the specific functionality of the trading system so that its national regulator can assess whether the system fits within the definition of an MTF or OTF and also assess compliance with the requirements under MIFID II for an MTF or OTF. The information to be provided includes, amongst other things, the asset classes of financial instruments traded on the platform, the rules and procedures that ensure non-discriminatory access to the platform, arrangements for market making and rules on suspension or removal from trading of a financial instrument. MTFs or OTFs will also need to notify their regulators of any material changes to the information previously submitted. The ITS also set out the format for the provision of this information. An OTF is a new category of trading platform that MiFID II and MiFIR will introduce. The ITS will apply from the date that the MiFID II Directive applies from.

The ITS are available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.137.01.0010.01.ENG&toc=OJ:L:2016:137:TOC.

EU Technical Standards on the Removal or Suspension of Financial Instruments from Trading

On May 24, 2016, a Commission Delegated Regulation outlining the RTS on when financial instruments should be removed or suspended from trading was adopted by the European Commission. The adopted RTS will supplement the

revised MiFID, which requires a market operator of a regulated market, multilateral trading facility or organized trading platform to suspend or remove from trading financial instruments which no longer comply with the rules of the trading platform. MiFID II requires that, when a market operator suspends or removes from trading a financial instrument, it must also suspend or remove the derivatives that relate or reference the underlying derivative where necessary to support the objectives of the suspension of the financial instrument. The RTS specify that a market operator of a regulated market and an investment firm, multilateral trading facility or organized trading facility must suspend or remove a derivative from trading where that derivative is related or references only one financial instrument and that instrument has been suspended or removed from trading. The RTS are applicable to derivatives listed in the first Annexure to MiFID II. The list includes: options, futures, swaps, forward rate agreements and any other derivative contracts dealing to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash. The adopted RTS do not apply to derivatives in which the price or value is dependent on multiple price inputs, for example, those that relate to an index or a basket of financial instruments.

The adopted RTS must be approved by the European Parliament and the Council of the European Union and be published in the Official Journal before they can enter into force.

The adopted RTS are available at: http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-3014-EN-F1-1.PDF.

EU Technical Standards on Admission of Financial Instruments to Trading

On May 24, 2016, a Commission Delegated Regulation outlining the RTS for the admission of financial instruments to trading on regulated markets was adopted by the European Commission. The adopted RTS will supplement the requirements set out in MiFID which requires a regulated market to have clear and transparent rules regarding the admission of financial instruments to trading. Such rules must ensure that any instruments admitted to trading are capable of being traded in a fair, orderly and efficient manner (and in the case of transferable securities, are freely negotiable). The adopted RTS specify the criteria for transferable securities to be considered freely negotiable, lay down the criteria for transferable securities, units and shares in collective investment undertakings and derivatives to be traded in a fair, orderly and efficient manner and outline the requirement for regulated markets to adopt and publish a policy to verify issuers' compliance with the obligations of initial, ongoing and ad hoc disclosures under EU law. The adopted RTS also confirms that emission allowances referred to under MiFID II are eligible for admission to trading with no further requirements and requires regulated markets to establish arrangements that are easily accessible and free of charge to facilitate participant or member access to information that has been made public.

The adopted RTS must be approved by the European Parliament and the Council of the European Union and be published in the Official Journal before they can enter into force.

The adopted RTS are available at: http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-3017-EN-F1-1.PDF.

Shadow Banking

Financial Stability Board Publishes Thematic Review on Policy Implementation and Shadow Banking

On May 25, 2016, the Financial Stability Board published its thematic review on the implementation of the FSB Framework for Shadow Banking Entities. The objective of the review was to evaluate the progress made by FSB jurisdictions in implementing the FSB's Policy Framework, in particular, evaluating efforts by entities based on economic functions and participation in the FSB information-sharing exercise. The FSB found that, despite progress having been made, the peer review findings indicated that implementation remains at a relatively early stage. The FSB concluded that more work is required to ensure that application of the Framework is sufficiently rigorous and that jurisdictions are able comprehensively to assess and respond to risks potentially posed by non-bank financial entities.

The FSB made two recommendations based on its findings. Firstly, jurisdictions should fully implement the policy framework and suggested actions to assist in implementation. For example, jurisdictions should establish a systematic process involving all relevant domestic authorities to assess the shadow banking risks posed by non-bank financial entities or activities and also address identified gaps in the availability of data by increasing information-collection powers.

Secondly, the FSB suggested a range of actions that it will take to facilitate the effective implementation of the Policy Framework. The FSB stated that it would, amongst other things, starting with its 2016 information-sharing exercise, strengthen the process of discussion and review as part of the information-sharing exercise to assist jurisdictions to learn from and enhance consistency in economic classification and risk assessment.

The thematic review is available at: http://www.fsb.org/wp-content/uploads/Shadow-banking-peer-review.pdf.

UK Regulator Publishes Paper on Issues and Contributions of Market-Based Finance

On May 26, 2016, the FCA published an Occasional Paper on the emerging issues and market contributions associated with market-based finance. The paper focuses on the more comprehensive concept of market-based finance, emphasizing the roles of markets and market-making mechanisms in the modern banking system. The FCA published the paper to better understand the impacts of market-based finance on the stability of the financial system as a whole. The FCA's findings are based on a substantial review of existing literature on market-based finance, trade press and various web sources and discussions with internal and external stakeholders.

The FCA concluded that the market-based finance system, if appropriately designed and supervised, can improve allocation of resources in the market place and reduce the cost of capital. In providing more diversified means of financing, the real economy is likely to become more resilient to adverse shocks, and the diversification of financing means increased competition with the traditional banking sector. The FCA highlighted the potentially significant risks associated with market-based finance if not properly understood and regulated. Issues of financial fragility can arise if associated infrastructure is badly designed and fails efficiently to distribute risks across the system. The FCA concluded that the greatest current risk is an insufficient understanding of the market-based finance system. In order to enhance currently regulatory framework, the FCA suggests that continued engagement with the market-based finance system on national and international levels is required.

The Occasional Paper is available at: http://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-18.pdf.

People

Financial Conduct Authority Appoints Permanent Director of Supervision

On May 27, 2016, the FCA announced that Megan Butler had been appointed to the role of Director of Supervision for the Investment, Wholesale and Specialists team. Ms. Butler has been on secondment at the FCA from the Prudential Regulation Authority as Temporary Head of Supervision. Ms. Butler was previously Executive Director of the International Banks Directive at the PRA and has also worked at the Financial Services Authority and the London Stock Exchange.

The FCA announcement is available at: http://www.fca.org.uk/news/megan-butler-appointed-permanent-director-supervision-investment-wholesale-specialists.

Upcoming Events

June 7: US Senate Committee on Banking, Housing and Urban Affairs hearing entitled "Bank Capital and Liquidity Regulation"

June 10: CFTC Roundtable on the CFTC's notice of proposed rulemaking regarding Regulation Automated Trading

June 21: US Senate Committee on Banking, Housing and Urban Affairs hearing entitled "Semiannual Monetary Policy Report to the Congress"

Upcoming Consultation Deadlines

June 2, 2016: UK Government Consultation on proposed amendments to anti-money laundering and counter-terrorist finance legislation

June 2, 2016: HM Treasury Consultation on UK Government's proposed secondary annuities market due to be introduced in April 2017

June 3, 2016: Federal Reserve Board Notice of Proposed Rulemaking on Single-Counterparty Credit Limits for Domestic and Foreign Bank Holding Companies

June 3, 2016: Federal Reserve Board Notice for Proposed Agency Information Collection Activities regarding New Data Items for Regulatory Reporting by Foreign Banking Organizations

June 3, 2016: Basel Committee Consultation on Standard Measurement Approach for Operational Risk

June 3, 2016: PRA Consultation on Risk-Based Levies for the Financial Services Compensation Scheme Deposit Class

June 7, 2016: UK CMA Provisional Decision on Remedies to Reform Retail Banking

June 10, 2016: Basel Committee Proposal for a Revised Pillar 3 Disclosure Framework

June 14, 2016: European Commission Consultation on Harmonizing EU Insolvency Regimes under its Capital Markets Union Action Plan

June 21, 2016: FCA Consultation on Proposed Rules and Guidance for the Secondary Annuity Market due to start in April 2017

June 22, 2016: EBA Consultation on Changes to Calculation of Interest Rate Risk on Capital Requirements

June 24, 2016: European Commission Consultation on Revisions to Capital Requirements Framework and EU Implementation of CRR

June 24, 2016: European Commission Consultation on EU Implementation of the Net Stable Funding Ratio

June 25, 2016: FDIC Notice of Proposed Rulemaking on Recordkeeping for Timely Deposit Insurance Determination

June 29, 2016: PRA Consultation on Underwriting Standards for Buy-to-Let Mortgage Contracts

July 6, 2016: Basel Committee Consultation paper on proposed revisions to the Basel III leverage ratio framework

July 6, 2016: EBA Consultation on amendments to the RTS for determining proxy spread and the specification of a limited number of smaller portfolios for credit valuation adjustment risk under the CRR

July 8, 2016: UK PSR Consultation on the application of provisions in the Interchange Fee Regulation

July 13, 2016: FCA Report on Investment and Corporate Banking Strategy

July 14, 2016: FCA and PRA Consultation on Proposed Implementation of the Enforcement Review and the Green Report

July 15, 2016: Basel Committee Consultation on Guidelines for Prudential Treatment of Problem Assets

July 19, 2016: FCA Consultation on UCITS, SFTR and consequential Changes to the Handbook

July 22, 2016: FCA Consultation on Proposed Guidelines for Wind-Down Planning

July 22, 2016: US Federal Reserve Board, OCC, FDIC, NCUA, FHFA and SEC Notice of Proposed Rulemaking on Incentive-Based Compensation Restrictions

July 29, 2016: PRA Consultation on future reporting of balance sheet, statement of profit and loss and forecast capital data

August 2, 2016: US Federal Reserve Board Advance Notice of Proposed Rulemaking on Capital Requirements for Supervised Institutions Significantly Engaged in Insurance

August 2, 2016: US Federal Reserve Board proposed rule on Enhanced Prudential Standards for Systemically Important Insurance Companies

August 2, 2016: US FinCEN notice of proposed rulemaking Imposing of Special Measure Against North Korea as a Jurisdiction of Primary Money Laundering Concern

August 4, 2016: EBA Consultation on risks and benefits associated with the innovative uses of consumer data by Financial Institutions

August 5, 2016: US Federal Reserve Board, OCC and FDIC Notice of Proposed Rulemaking to Establish the Net Stable Funding Ratio

August 5, 2016: US Federal Reserve Board Notice of Proposed Rulemaking on Restrictions on Qualified Financial Contracts of Systemically Important US Banking Organizations and the US Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions

August 11, 2016: EBA Consultation on LCR Disclosure and Disclosure of Liquidity Risk Management

August 12, 2016: PRA Consultation on Pillar 2 Liquidity Risk 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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