

Financial Regulatory Developments Focus



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

Regulatory Capital

EBA Publishes Draft RTS on Bankers' Bonuses

On 19 February 2014, the European Banking Authority (“EBA”) published final draft Regulatory Technical Standards (“RTS”) on classes of instruments that can be used as variable remuneration. The RTS specify requirements for Tier 1 and 2 instruments and other instruments and define the write-down, write-up and conversion mechanisms for Tier 2 and other instruments. Under the Capital Requirements Directive (“CRD”), firms are required to award at least 50% of the variable remuneration of staff who have a material impact on the firm’s risk profile, in instruments. The instruments must consist of shares, share-linked or equivalent non-cash instruments and, where possible, Additional Tier 1, Tier 2 or other instruments. The draft RTS are subject to endorsement by the European Commission. Once in force, the RTS will apply across the EU. The remuneration requirements under CRD have applied since 1 January 2014.

The final draft RTS are available at:

<http://www.eba.europa.eu/documents/10180/589319/EBA+RTS+2014+02+%28RTS+on+instruments+for+variable+remuneration%29.pdf>.

EBA Publishes Discussion Paper on the Impact on the Volatility of Own Funds of the Accounting and Prudential Changes in the Treatment of Defined Benefit Pension Plans

On 17 February 2014, the EBA published a discussion paper on the impact on the volatility of own funds of the accounting and prudential changes in the treatment of defined benefit pension plans. Under the Capital Requirements Regulation (“CRR”), the EBA is responsible for preparing a report to the Commission on this issue. The European Commission must prepare a report to the European Council and Parliament on the issue by 31 December 2014 and, if necessary, propose legislative measures to adjust net benefit pension fund assets or liabilities for the calculation of own funds. Under the CRR, firms must deduct net defined benefit

pension assets from Common Equity Tier 1. Comments on the discussion paper are due by 14 April 2014.

The discussion paper is available at:

<http://www.eba.europa.eu/documents/10180/583941/EBA+DP+2014+01+%28DP+on+Pensions%29.pdf>.

Federal Reserve Board Approves Final Rule Strengthening Supervision and Regulation of Large US Bank Holding Companies and Foreign Banking Organizations

On 18 February 2014, the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) approved a final rule strengthening supervision and regulation of large US bank holding companies and foreign banking organizations. The final rule establishes a number of enhanced prudential standards for large US bank holding companies and foreign banking organizations to help increase the resiliency of their operations. These standards include liquidity, risk management, and capital. It also requires a foreign banking organization with a significant US presence to establish an intermediate holding company over its US subsidiaries, which will facilitate consistent supervision and regulation of the US operations of the foreign bank. The final rule was required by section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. US bank holding companies subject to the rule will need to comply by 1 January 2015.

The full text of the Federal Reserve Board final rule is available at:

<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140218a1.pdf>.

FDIC Extends Public Comment Period for Single Point of Entry Resolution Strategy

On 18 February 2014, the Federal Deposit Insurance Corporation (the “FDIC”) announced that it has extended the comment period for the Single Point of Entry (“SPOE”) strategy for the resolution of Systemically Important Financial Institutions. All comments on the SPOE strategy must now be received on or before 20 March 2014.

The full text of the extension notice can be found at:

<http://www.fdic.gov/news/news/press/2014/pr14010a.pdf>.

Federal Agencies Permit Certain Banking Organizations to Begin Using Advanced Approaches Framework to Determine Risk-Based Capital Requirements

On 21 February 2014, the Federal Reserve Board and the Office of the Comptroller of the Currency (“OCC”) permitted certain banking organizations to begin using an additional approach to determine their risk-based capital requirements. Under the agencies’ “Advanced Approaches” capital framework, which implements standards developed by the Basel Committee on Banking Supervision, firms must meet specific risk measurement and management criteria when calculating their risk-based capital requirements. The framework applies to large, internationally active banking organizations—generally those with at least

\$250 billion in total consolidated assets or at least \$10 billion in total on-balance sheet foreign exposure—and includes the depository institution subsidiaries of those firms. Concurrently, the Federal Reserve Board issued a final rule clarifying that bank holding companies using the Advanced Approaches framework will incorporate those changes into the capital planning and stress testing cycles that begin 1 October 2015. The final rule provides the Federal Reserve Board and the institutions additional time to integrate the Advanced Approaches framework into their respective stress testing and capital planning processes.

The full text of the Federal Reserve Board final rule is available at:

<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20140221.pdf>.

Financial Services

EU Political Agreement on Proposed Deposit Guarantee Scheme Directive

The Council of the European Council announced on 18 February 2014 that it had reached political agreement with the European Parliament on the proposed Deposit Guarantee Scheme Directive (the “DGS Directive”) that revises the current European legislation in place. The new DGS Directive will ensure better protection for depositors of EU banks. In addition to increasing the level of coverage of deposits to EUR100,000, the DGS Directive will reduce the time limit for paying out depositors from 20 to 7 working days from 2024. The final text of the DGS Directive is still to be adopted formally by the European parliament. EU member states will have one year from the entry into force of the DGS Directive to transpose its provisions into national law.

The Council’s announcement is available at:

http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/141059.pdf.

ESMA Publishes Third Annual Report on EU Credit Rating Agencies

The European Securities and Markets Authority (“ESMA”) published its third annual report on EU credit rating agencies on 21 February 2014. ESMA considers that credit rating agencies have improved their compliance with the Credit Rating Agencies Regulation, however, improvements are necessary on the validation of rating methodologies, internal governance and IT systems. In addition to completing the current reviews into the monitoring of structured finance ratings by rating agencies and on small and medium-sized agencies, ESMA intends to launch a new review into how credit rating agencies review and validate their rating methodologies.

ESMA’s report is available at: <http://www.esma.europa.eu/news/Press-release-ESMA-sets-out-CRA-supervision-focus-2014?t=326&o=home>.

First Commencement Order under UK Banking Reform Act

On 19 February 2014, the first commencement Order under the UK Banking Reform Act 2013 was made. The Order brings into force certain provisions on 1 March 2014 for all purposes, including in relation to ring-fencing transfer schemes, financial services compensation scheme and the regulation of payment systems. The Order also brings into force, on 1 March 2014, certain provisions for the purpose of making rules, regulations and orders, including provisions on ring-fencing and the bail-in stabilisation option.

A copy of the commencement Order is available at:

http://www.legislation.gov.uk/ukxi/2014/377/pdfs/ukxi_20140377_en.pdf.

You may like to see our client note on the ring-fencing provisions of the Banking Reform Act, available at:

<http://www.shearman.com/en/newsinsights/publications/2013/12/vickers-recommendations-on-bank-ring-fencing>.

SEC Announces Initiative Directed at Never-Before Examined Registered Investment Advisers

On 20 February 2014, the Securities and Exchange Commission (“SEC”) announced that its Office of Compliance Inspections and Examinations (“OCIE”) is launching an initiative directed at investment advisers that have never been examined, focusing on those that have been registered with the SEC for three or more years. As part of the initiative, OCIE will conduct examinations of a significant percentage of advisers that have not been examined since they registered with the SEC. These examinations will concentrate on the advisers’ compliance programs, filings and disclosure, marketing, portfolio management, and safekeeping of client assets.

Additional details on the examinations are available at:

<http://www.sec.gov/about/offices/ocie/nbe-final-letter-022014.pdf>.

Federal Reserve Board to Begin Publishing Semi-Annual Report With Aggregate Data and Other Information Regarding Banking Applications

On 24 February 2014, the Federal Reserve Board announced that it will soon begin publishing a semi-annual report with aggregate data and other information regarding banking applications. The report will be released in the second half of 2014 and include statistics on the length of time taken to process applications and notices, the number of approvals, denials, and withdrawals, and the primary reasons for withdrawals.

Concurrently, the Federal Reserve Board released guidance describing common issues identified by the Federal Reserve Board that have led to recent withdrawal of applications. Some of those issues include less-than-satisfactory supervisory rating(s) for safety and soundness, consumer compliance; inadequate compliance with the Bank Secrecy Act; and concerns regarding the financial condition or management of the proposed organization.

The full text of the Federal Reserve Board guidance can be found at:
<http://www.federalreserve.gov/newsevents/press/bcreg/2014bcreg.htm>

Funds

ESMA publishes AIFMD Q&As

On 17 February 2014, ESMA published Questions and Answers (“Q&As”) which aim to promote common supervisory approaches and practices on the application of the Alternative Investment Funds Managers Directive (“AIFMD”) and its implementing measures. The Q&As, which cover remuneration and disclosure and reporting requirements, are aimed at regulators under the AIFMD and are intended to provide clarity to Alternative Investment Fund Managers on the content of the AIFMD rules.

The Q&As are available at http://www.esma.europa.eu/system/files/2014-163_qa_on_aifmd_february_for_publication.pdf.

ESMA Publishes Final Draft ITS

On 20 February 2014, ESMA published two final draft Implementing Technical Standards (“ITS”) on the form of notifications to be made under the European social entrepreneurship funds Regulation and the European venture capital funds Regulation.

The draft ITS are available at: http://www.esma.europa.eu/system/files/2014-esma-161_draft_its_on_notification_-_eusef.pdf.

and

http://www.esma.europa.eu/system/files/2014-esma-160_draft_its_on_notification_-_euveca.pdf.

Enforcement

CFTC Charges Individuals with Fraudulent Solicitation, False Statements, and Misappropriation of More than \$1.6 Million of Customer Funds

On 19 February 2014, the US Commodity Futures Trading Commission (“CFTC”) filed an enforcement action in the US District Court, Eastern District of North Carolina, charging Ron Earl McCullough and David Christopher Mayhew with fraudulently soliciting, directly and through others, approximately \$2.3 million from at least 11 individuals to trade leveraged or margined off-exchange foreign currency (forex) contracts. Further, the CFTC complaint alleges that McCullough and Mayhew misappropriated at least \$1.6 million of their customers’ funds. The CFTC Complaint alleges that McCullough and Mayhew, directly and through others, misrepresented the risks of trading forex; falsely guaranteed the return of customers’ principal; falsely promised high returns, including double returns in short periods of time; and failed to disclose that they

intended to use customer funds to pay principal and purported profits to other customers and for personal expenses.

The full text of the CFTC complaint can be found at:

<http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfmcculloughcomplaint021814.pdf>.

Credit Suisse Agrees to Pay \$196 Million and Admits Wrongdoing in Providing Unregistered Services to US Clients

On 21 February 2014, the SEC announced charges against Credit Suisse Group AG for violating the federal securities laws by providing cross-border brokerage and investment advisory services to US clients without first registering with the SEC. According to the SEC's order instituting settled administrative proceedings, Credit Suisse relationship managers traveled to the US to solicit clients, provide investment advice, and induce securities transactions. These relationship managers were not registered to provide brokerage or advisory services, nor were they affiliated with a registered entity. The relationship managers also communicated with clients in the US through overseas e-mails and phone calls. Credit Suisse was aware of the registration requirements of the federal securities laws and undertook initiatives designed to prevent such violations. These initiatives largely failed, however, because they were not effectively implemented or monitored.

The full text of the SEC enforcement order is available at:

<http://www.sec.gov/litigation/admin/2014/34-71593.pdf>.

Events

26 February: The Dodd-Frank Act's Impact on Asset-Backed Securities (House Committee on Financial Services)

27 February: The Semi-annual Monetary Policy Report to the Congress (Senate Committee on Banking, Housing & Urban Affairs)

28 February: Equity Market Structure: A Review of SEC Regulation NMS (House Committee on Financial Services)

10 March 2014: The European Commission is holding a public hearing on the liquidity coverage requirement and leverage ratio. Registration is available at:

http://ec.europa.eu/internal_market/conferences/2014/0310-lcr-lr-hearing/index_en.htm.

People

Stephen Luparello Named as Director of SEC's Division of Trading and Markets

On 20 February 2014, the SEC announced that it has named Stephen Luparello as director of its Division of Trading and Markets.

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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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