SHEARMAN & STERLING LLP

A QUARTERLY NEWSLETTER FOR COMPANIES AND FINANCIAL INSTITUTIONS

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Governance & Securities Law Focus: Latin America Edition

In this issue:

This newsletter provides a snapshot of the principal US and selected global governance and securities law developments during the fourth quarter of 2013 that may be of interest to Latin American corporations and financial institutions.

The previous Governance & Securities Law Focus newsletter is available here.

US DEVELOPMENTS

SEC Developments

Iran Notices Update: SEC-Registered Issuers Continue to Adapt to Their New Normal

It has been over 10 months since the US Securities and Exchange Commission ("SEC") registered issuers began making mandatory disclosures of business activities in or with Iran pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 ("ITRA") (codified as Section 13(r) of the US Securities Exchange Act of 1934, as amended (the "Exchange Act")). During that period, issuers have filed over 400 Iran Notices with the SEC, including numerous repeat filers.

- On 4 November 2013, we published a client publication reviewing the Iran Notices filed to date and assessing trends in disclosure. Noteworthy trends include:
- The collective disclosures reveal an emerging consensus as to the structure and content of a Section 219 disclosure.
- Reporting issuers continue to recognise that the SEC interprets both "affiliate" and "control" broadly.

- Private equity firms and sponsors are triggering intricate and overlapping reporting trees.
- Reporting issuers are revamping their internal controls to accommodate their new reporting obligations.
- Reporting issuers continue to make disclosures of de minimis conduct.
- Some issuers are reading Section 219 as having a duty to update.
- Disclosures vary drastically in scope and detail across industries.
- As of October 2013, the government has not announced the results of any of the mandatory investigations triggered by Section 219 disclosures.

For further detail, our related client publication available at:

http://www.shearman.com/en/newsinsights/publications/2013/11/iran-notices-update-secregistered-issuers-contin

Conflict Minerals Rules Update

31 December 2013 marked the end of the first reporting period for the SEC's conflict minerals rules. Under these rules, SEC reporting companies that manufacture products that contain tantalum, tin, tungsten or gold must make inquiries, and potentially undertake due diligence, regarding the source of those minerals and face certain specific reporting requirements.

Conflict minerals disclosure for the year ended 31 December 2013 must be filed with the SEC on a specialised disclosure report on Form SD on or before 31 May 2014. Each SEC reporting company is required to make its Form SD available on its company website for one year. To date, no conflict minerals disclosures on Form SD have been filed, but we will be following developments in this area closely.

Our client publications providing updates and guidance on the SEC conflict minerals rules are available at:

http://www.shearman.com/en/newsinsights/publications/2012/12/all-that-glitters-may-be-a-reportable-conflict-m; and

http://www.shearman.com/en/newsinsights/publications/2013/05/sec-staff-issues-guidance-on-conflict-minerals

SEC Enforcement Actions in FY 2013 Result in Record Monetary Sanctions

The SEC announced that its enforcement actions in fiscal year 2013 (year ended 30 September 2013) resulted in a record $3.4 billion in monetary sanctions ordered against wrongdoers. The SEC filed 686 enforcement actions in fiscal year 2013. The $3.4 billion in disgorgement and penalties resulting from those actions is 10% higher than fiscal year 2012 and 22% higher than fiscal year 2011, when the SEC filed the most actions in its history.

The SEC received 3,238 whistleblower tips in fiscal year 2013 and paid more than $14 million to whistleblowers whose information substantially advanced enforcement actions.

During the year, the SEC changed its settlement policy and now requires admissions of misconduct in a discrete category of cases where heightened accountability and acceptance of responsibility by a defendant are appropriate and in the public interest. This shift marks an important departure from the agency's longstanding practice of allowing parties to settle civil enforcement actions without admitting or denying liability. The first settlements under the new policy came in actions against Philip A. Falcone and his firm Harbinger Capital Partners, and JPMorgan Chase & Co.

The SEC announced that it has a strong enforcement pipeline heading into fiscal year 2014, having opened 908 investigations in fiscal year 2013 (up 13%) and obtained 574 formal orders of investigation (up 20%).

The SEC's press release is available at:

http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540503617

SEC Releases Interpretive Guidance on "Bad Actor" Disqualifications for Rule 506 Private Placement Exemption

As discussed in the October 2013 issue of *Governance & Securities Law Focus*, the SEC, as part of its rule changes under the 2012 Jumpstart Our Business Startups Act ("JOBS Act") permitting general solicitation and general advertising in private placements, adopted rule changes disqualifying felons and other bad actors from being able to rely on the Securities Act Rule 506 safe harbour for private placements to "accredited investors."

On 3 January 2014, the SEC published new compliance and disclosure interpretations ("C&DIs") relating to the "bad actor" disqualification in Rule 506(d). This rule makes the Rule 506 safe harbour unavailable if, among other specified persons, any "beneficial owner" of 20% or more of an issuer's outstanding voting equity securities is a felon or other bad actor. The new C&DIs principally relate to the interpretation of "beneficial ownership."

SEC Issues Staff Report on Public Company Disclosure

On 20 December 2013, the SEC issued a staff report to Congress on its disclosure rules for US public companies, as part of the SEC's ongoing efforts to modernise and simplify disclosure requirements and reduce compliance costs for emerging growth companies.

The report, mandated by Congress in the JOBS Act, offers an overview of the SEC's Regulation S K that governs public company disclosure, as well as the staff's preliminary conclusions and recommendations. Regulation S K contains the disclosure requirements applicable to US domestic issuers. While the SEC disclosure requirements relating to foreign private issuers cover many of the same matters as set forth in Regulation S K, the staff's review did not encompass the disclosure requirements for foreign private issuers.

In the report, the SEC staff recommends the development of a plan to systematically review (on either a comprehensive or a targeted basis) the disclosure requirements in the SEC's rules and forms, including Regulation S K and Regulation S X, and the related rules concerning the presentation and delivery of information to investors and the marketplace. After conducting the review and related information gathering, the staff would, as appropriate, recommend to the SEC proposals for revisions to the SEC's disclosure requirements.

As part of this effort, the SEC's Office of the Chief Accountant will coordinate with the Financial Accounting Standards Board to identify ways to improve the effectiveness of disclosures in corporate financial statements and to minimise duplication with other existing disclosure requirements.

On 15 October 2013, in a speech to the National Association of Corporate Directors, SEC Chair Mary Jo White discussed the need for review of the SEC's disclosure rules and the aims for reform of the rules to keep pace with industry developments and technological advances in the way investors receive information, as well as to address "information overload". As an example, Chair White noted the SEC Industry Guides, which have often not been revised to reflect the significant changes that have taken place in recent years in the industries covered by the Guides. She queried whether Industry Guide 7, applicable to public mining companies, should be revised based on the international standards for reporting resources and reserves that have been developed by the international mining community and adopted in the securities laws of other jurisdictions.

The SEC's staff report to Congress is available at:

http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540530982

Chair White's speech to the National Association of Corporate Directors is available at:

http://www.sec.gov/News/Speech/Detail/Speech/1370539878806

Recent Trends and Patterns in the Enforcement of the Foreign Corrupt Practices Act ("FCPA")

In January 2014, we published our bi-annual "Recent Trends and Patterns in FCPA Enforcement" report, part of our FCPA Digest, which together provide an insightful analysis of recent trends and patterns and compendium of all FCPA enforcement actions and private actions.

Last year, in *Trends & Patterns*, we noted that 2012 had been "a fairly slow time" in terms of corporate enforcement actions, with 12 enforcement actions against corporations. 2013 was slower still, with only nine corporate enforcement actions. There was a steep increase in corporate fines, however, and enforcement against individuals saw a marked increase, from five in 2012 to 16 in 2013—eight of whom pleaded guilty.

Among the highlights:

- over $720 million in penalties in 2013, and the average penalties ($80 million) and the adjusted average ($28 million) were both considerably up from previous years;
- significant number of new cases against individuals;
- surge in "hybrid" monitors, with an independent monitor's term of 18 months followed by 18 months of self-monitoring;
- continued aggressive theories of jurisdiction and parent subsidiary liability asserted by the SEC and US Department of Justice; and
- adoption of deferred prosecution agreements in the UK, albeit with substantially more judicial involvement than in the US.

Our January 2014 report is available at:

http://www.shearman.com/en/newsinsights/publications/2014/fcpa-digest

Sanctions Round Up

On 7 January 2014, we published the fourth quarter 2013 issue of our quarterly *Sanctions Round-Up*.

As 2013 drew to a close, a potentially ground-breaking agreement was reached with Iran regarding its nuclear program, leading to much speculation about how certain sanctions might be suspended, and under what conditions. While the majority of the actions in 2013 focused on Iran, the Office of Foreign Assets Control of the US Department of the Treasury ("OFAC") continued to announce a number of designations made under the other US sanctions programs, including those targeting terrorism, transnational criminal organisations and narcotics traffickers. OFAC also announced a handful of settlements stemming from apparent sanctions-related violations, including the largest ever settlement with a non-financial institution. Finally, the EU took steps to re-blacklist a number of persons whose designations had previously been annulled by EU courts while those courts continued to review additional contested designations.

Our Sanctions Round-Up: Fourth Quarter 2013 is available at:

http://www.shearman.com/en/newsinsights/publications/2014/sanctions-round-up-fourth-quarter-2013

Noteworthy US Securities Law Litigation

Halliburton Corporation v. Erica P. John Fund, Inc.: US Supreme Court to Reconsider "Fraud-On-The-Market" Theory

In November 2013, the US Supreme Court agreed to hear an appeal that, depending how the Court rules, could make it much more difficult for plaintiffs to obtain class certification in securities fraud cases. At issue in Halliburton is the continuing validity of the "fraud-on-the-market" theory—a legal presumption that each member of a purported class relied on the allegedly fraudulent statement in purchasing or selling its securities.

As background, a plaintiff must satisfy certain requirements under Rule 23 of the Federal Rules in order to obtain class certification. Rule 23(b)(3) requires that questions of law or fact common to class members predominate over any questions affecting only individual members. In the 1980s, defendants often asserted that securities fraud cases were not suitable for class certification because each member of the proposed class had to prove the element of reliance—i.e., that an investor relied on the defendant's alleged misstatement prior to purchasing the share. The Supreme Court, in *Basic v. Levinson* (1988), rejected this argument and held that the market price of shares traded on a well-developed market reflects all publicly available information, and therefore, it is presumed that an investor relies on a public misstatement whenever he purchases a share. This doctrine—known as the fraud-on-the-market theory—creates a rebuttable presumption of reliance for proposed class members and makes it possible for them to satisfy the predominance requirement of Rule 23(b)(3).

One of the issues on appeal is whether the economic underpinnings for the fraud-on-the-market theory are valid, and if not, whether the Court should overrule *Basic*. Oral argument is schedule for 5 March 2014, and the Supreme Court should issue a decision by July 2014.

If the Court overturns *Basic*, it will have a significant impact on securities fraud class actions because, without the benefit of the fraud-on-the-market presumption of reliance, it would be nearly impossible for plaintiffs to prove that each member of the class actually relied on the alleged misstatement when purchasing or selling securities.

In re BP p.l.c Securities Litigation: BP Shareholders Denied Class Certification in Deepwater Horizon Suit

In December 2013, a federal district court denied a motion for class certification and ruled that the plaintiffs failed to establish by a preponderance of the evidence that damages could be measured on a class-wide basis consistent with their theories of liability. The court based its decision on the Supreme Court's recent decision in *Comcast v. Behrend*, which, in the district court's view, mandated "a significant shift in the scrutiny required for class certification."

In *Comcast*, plaintiffs submitted an expert report in support of their motion for class certification that assumed the validity of four theories of antitrust injury, even though the court had already rejected three of those theories at the motion to dismiss stage. On appeal, the Supreme Court ruled that, in light of the expert's failure to differentiate between losses generally and losses attributable to the only remaining viable theory of liability, the plaintiff had not established that damages are capable of measurement across the entire class, as required by Rule 23(b)(3) of the Federal Rules.

As in *Comcast*, the court in *In re BP* ruled that the plaintiffs had not presented sufficient evidence that damages were capable of calculation on a class-wide basis, consistent with their theory of liability. The court explained that, prior to *Comcast*, the plaintiffs' stated intention to perform an event study to calculate damages might have been sufficient to satisfy a court that damages were measurable on a class-wide basis. After *Comcast*, however, it is necessary to rigorously examine proposed damages methodologies to ensure that the plaintiffs' proposed methodology will track their theories of liability. The court held that, without a more complete explanation of how plaintiffs propose to use an event study to calculate class members' damages and incorporate the various theories of liability, it could not certify the class.

This case highlights the increased burden that courts are imposing on plaintiffs at the class certification stage and the increased scrutiny that courts will give to plaintiffs' damages methodologies following *Comcast*.

Recent SEC/DOJ Enforcement Matters

SEC Announces First Deferred Prosecution Agreement with an Individual

In November 2013, the SEC announced a deferred prosecution agreement ("DPA") with a hedge fund administrator who helped the SEC uncover a scheme by the founder of the hedge fund to steal investor assets. The SEC declined to bring an action against the administrator, even though he aided and abetted the securities law violations, because of his significant assistance in stopping the fraud.

In September 2012, after working at the hedge fund for nearly two years, the hedge fund administrator resigned and contacted government authorities to report that the founder was stealing money from the fund and overstating the fund's performance to investors. In addition, the fund administrator voluntarily produced voluminous documents to the SEC that it used to file an emergency action to halt the fraud and freeze the hedge fund's assets.

Under the terms of the DPA, the administrator cannot provide any services to a hedge fund for five years, cannot associate with any broker-dealer, investment advisor, or registered investment company for five years, and has to disgorge approximately $50,000 in fees he received for serving as the administrator. If the administrator complies with these provisions, the SEC will not take any further action against him.

This case was the first time that the SEC has agreed to enter into a DPA with an individual. DPAs are part of a broader initiative by the SEC to induce individuals and companies to self-report securities laws violations in exchange for potentially less harsh sanctions.

Alcoa Settles FCPA Probe

In January 2014, Alcoa World Alumina LLC, a subsidiary of Alcoa Inc., agreed to plead guilty to one count of violating the anti-bribery provision of the FCPA. According to the plea agreement, Alcoa World Alumina paid fake commissions to a consultant who, in turn, used the money to pay bribes to senior government officials in Bahrain in order to secure contracts with Aluminium Bahrain B.S.C., an aluminium manufacturer owned primarily by the Kingdom of Bahrain.

As part of the guilty plea, Alcoa World Alumina agreed to pay a criminal fine of $209 million and to administratively forfeit $14 million. In addition, Alcoa agreed to maintain and implement an enhanced global anti-corporation compliance program.

In a parallel action, Alcoa settled with the SEC and will pay an additional $161 million in disgorgement, bringing the total amount of US criminal and regulatory penalties paid by Alcoa and Alcoa World Alumina to $384 million. The $384 million settlement is the fifth largest FCPA settlement ever.

Employment Benefits Updates

ISS Publishes 2014 Corporate Governance Policy Updates

On 21 November 2013, Institutional Shareholder Services Inc. ("ISS") released its final US policy updates for the 2014 proxy season (the "2014 Policies"). There are only three updates for the US, none of which represent a significant change. The first modifies ISS's pay for performance quantitative screen, the second clarifies ISS's policy on board responsiveness to majority supported shareholder proposals and the third modifies the existing ISS policies on shareholder proposals related to lobbying and human rights. The 2014 Policies will generally be effective for shareholder meetings of publicly traded companies occurring after 1 February 2014.

The 2014 Policies are available at:

http://www.issgovernance.com/policy/2014/policy_information

Pay for Performance Quantitative Screen

Under its current policies (the "2013 Policies"), ISS uses two principal quantitative screens to identify companies where a potential pay for performance misalignment merits a deeper qualitative analysis of the pay program—absolute degree of alignment ("Absolute Alignment") and relative degree of alignment ("RDA"). The Absolute Alignment screen measures alignment between CEO pay and total shareholder return ("TSR") over the prior five fiscal years. The RDA screen measures the degree of alignment between the company's TSR and the CEO's total pay, as compared against the company's peers and as measured over one year and three year periods (weighted 40% and 60%, respectively).

The 2014 Policies simplify the methodology for calculating the RDA screen by limiting its review to a single three-year period (or any shorter period during which the company has disclosed pay data). Each year of TSR will be weighted equally rather than over-emphasising the most recent year, as was the case under the 2013 Policies.

Board Responsiveness to Majority Supported Shareholder Proposals

In the 2014 Policies, ISS determined to fully implement the changes to its policy on board responsiveness to majority supported shareholder proposals that were introduced by the 2013 Policies, subject to certain clarifying changes as follows:

- ISS will issue a negative vote recommendation for the board or individual directors if a board fails to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year;
- ISS included additional guidance on the factors it will take into account in examining the sufficiency of the board's action in response to a majority-supported proposal; and
- ISS will apply a case-by-case judgment in determining which directors will be subject to a negative vote recommendation in the event that the level of responsiveness to a majority supported proposal is found to be insufficient. Responsiveness is deemed to be insufficient if there is less than full implementation of the proposal.

Under the 2014 Policies, the factors for assessing board responsiveness to majority vote proposals are: (1) the rationale provided in the proxy statement for the level of implementation (a new factor added by the 2014 Policies); (2) the subject matter of the proposal; (3) the level of support and opposition provided to the resolution in past meetings; (4) disclosed outreach efforts by the board to shareholders in the wake of the vote; (5) actions taken by the board in response to its engagement with shareholders; (6) the continuation of the underlying issue as a voting item on the ballot; and (7) other factors as appropriate.

Lobbying and Human Rights Risk Assessment

The 2013 Policies expanded the scope of ISS's policy regarding shareholder proposals requesting information on a company's lobbying activities to cover all types of lobbying proposals. The 2014 Policies generally maintain the same scope and focus as the 2013 Policies, but modify the language to better reflect the factors considered in ISS's analysis. The factors considered under the 2014 Policies are: (1) current disclosure of relevant lobbying policies, and management and board oversight; (2) disclosure regarding trade associations or other groups that the company supports, or is a member of, that engage in lobbying activities; and (3) recent significant controversies, fines, or litigation regarding the company's lobbying related activities.

In the 2014 Policies, ISS introduces a new policy regarding shareholder proposals that ask companies to either perform a human rights risk assessment or report on their human rights risk assessment process. ISS has set forth the following factors that it will consider in making its recommendation: (1) the degree to which existing relevant policies and practices are disclosed, including information on the implementation of these policies and any related oversight mechanisms; (2) the company's industry and whether the company or its suppliers operate in countries or areas where there is a history of human rights concerns; (3) recent, significant controversies, fines, or litigation regarding human rights involving the company or its suppliers, and whether the company has taken remedial steps; and (4) whether the proposal is unduly burdensome or overly prescriptive.

Benchmark Policy Consultation

ISS also announced the opening of a "consultation period" during which it is seeking market feedback on areas under consideration for longer-term policy changes (beyond 2014), including director tenure, director independence, auditor ratification and equity—based compensation plans. The consultation period ends on 14 February 2014.

Our related client publication is available at:

http://www.shearman.com/en/newsinsights/publications/2013/11/iss-publishes-2014-corp-gov-policy-updates

Nasdaq Proposes Modifications to Compensation Committee Independence Requirements

On 26 November 2013, the NASDAQ Stock Market ("Nasdaq") filed a proposal to amend its listing standards regarding compensation committee independence (the "Proposal"). The modifications would provide Nasdaq-listed companies with greater flexibility in determining compensation committee independence by eliminating the bright line prohibition on the receipt of compensatory fees by compensation committee members. Instead, boards of directors would only be required to "consider" the receipt of such fees when determining eligibility for compensation committee membership. Overall, the Proposal brings the Nasdaq standards in line with the current New York Stock Exchange (the "NYSE") requirements.

The modifications do not affect the exemptions available to foreign private issuers; the listing standards, as amended, will continue to exempt from the compensation committee independence requirements foreign private issuers that follow their home country corporate governance practices, provided that the foreign private issuer discloses each Nasdaq listing requirement that it does not follow and describes its applicable home country practice.

Background

Pursuant to Rule 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, on 20 June 2012, the SEC issued final rules (the "Final Rules") directing the national securities exchanges to adopt listing standards relating to the independence of compensation committees and their selection of advisors.

On 11 January 2013, the SEC approved final listing standards for both Nasdaq and the NYSE. The Nasdaq listing standards provided that a director would not be independent (and hence not eligible to serve on a compensation committee), if the director received any consulting, advisory or other compensatory fee from the listed company. Expressly excluded from the ban were fees received by the director as (i) a member of the board or any board committee, and (ii) fixed amounts of compensation under a retirement plan for prior service with the company. In contrast, the NYSE listing standards require the board to consider "all factors specifically relevant to determining whether a director has a relationship to the listed company that is material to the director's ability to be independent from management". The NYSE rules do not prohibit members of the compensation committee from receiving compensation from the listed company.

A discussion of the NYSE and Nasdaq listing standards is available at:

http://www.shearman.com/en/newsinsights/publications/2013/01/sec-approves-nyse-and-nasdaq-listing-standards-f

Proposed Amendments

Source of Fees

Nasdaq indicated that it had received feedback from listed companies that the prohibition on compensatory fees would create a burden on issuers, particularly in industries such as energy and banking, where it is common to have a director who conducts a *de minimis* amount of business with the issuer. To alleviate these burdens, Nasdaq has proposed to eliminate the prohibition and to adopt the same standard used by the NYSE.

Under the Proposal, a company's board must consider the source of all compensation of the director who will serve on the company's compensation committee, including any consulting, advisory or other compensatory fee paid by the company to the director. The current exceptions for board and committee fees and retirement compensation would be eliminated. In reviewing the source of compensation, the board should consider whether the director receives compensation from any person or entity that would impair the director's ability to make independent judgments about the company's executive compensation.

Notwithstanding the elimination of the prohibition against compensation, a compensation committee member will not be allowed to receive unlimited fees, as the member must continue to meet the general Nasdaq independence standards, which set overall caps on the amount of compensation that an independent director can receive from the company.[1]

[1]These standards provide that a director will not be independent if (i) the director accepted, or had a family member who accepted, compensation from the company exceeding $120,000 during any period of 12 consecutive months within the three years preceding the independence determination, and (ii) the director is, or has a family member who is, a partner in, or a controlling shareholder or an executive officer of, any organisation to which the company made, or from which the company received, payments for property or services in the current or any of the past three years that exceed the greater of 5% of the recipient's gross revenues for that year or $200,000.

Under the Proposal, boards would need to consider whether any fees, even those below the caps, would impair a director's ability to make independent judgments regarding executive compensation.

Other Modifications

Nasdaq proposes a few additional modifications. First, the Proposal provides that, in affirmatively determining the independence of any director who will serve on the compensation committee, the board must "consider all factors specifically relevant to determining whether a director has a relationship to the company which is material to that directors' ability to be independent from management in connection with the duties of a compensation committee member." The NYSE listing standards contains the same requirement.

Second, the current listing standards (and the Final Rules) oblige the board to consider whether the director has an affiliate relationship with the company, a subsidiary of the company or an affiliate of a subsidiary of the company.

Finally, the Proposal clarifies the definition of "company" in the listing standards to include any parent, subsidiary or other entity that the company controls and consolidates with the company's financial statements as filed with the SEC.

Effective Dates

The Proposal became effective immediately pursuant to Rule 19b-4(f)(6) under the Exchange Act, although Nasdaq provided for a 21-day comment period from the date of publication in the Federal Register. Nasdaq has not modified the implementation deadline for the compensation committee independence requirements; listed companies must comply with the rules by the earlier of their first annual meeting after January 2014 and 31 October 2014. Each listed company is required to submit a one-time certification of compliance with the amended rules within 30 days after the applicable implementation date. The certification form will be available on the Nasdaq OMX Listing Center no later than 15 January 2014.

Our related client publication is available at:

http://www.shearman.com/en/newsinsights/publications/2013/12/nasdaq-proposes-modifications

California Reduces Rate of Section 409A State Excise Tax

California recently reduced its excise tax rate imposed on service providers for failures to comply with the California analog to Section 409A of the Internal Revenue Code of 1986, as amended ("Section 409A"). California Assembly Bill 1173, which was signed into law on 4 October 2013, provides that, for taxable years beginning 1 January 2013, the excise tax rate imposed by California for non-compliance with California's equivalent of Section 409A has been reduced from 20% to 5%.

Section 409A governs nonqualified deferred compensation plans, which are, generally, arrangements that provide for the payment of compensation in a year later than the year in which the compensation was earned. Plans, agreements and arrangements providing for payments that may be subject to Section 409A include employment agreements, severance agreements, change in control agreements, discounted stock options and phantom equity arrangements, such as restricted stock units. If a nonqualified deferred compensation plan does not comply with Section 409A, individuals eligible to receive payments under the plan will be subject to a 20% Section 409A federal excise tax, in addition to standard federal and state taxes.

California implemented its own version of Section 409A, which generally mirrors the Federal version. Prior to the Assembly Bill 1173 rate reduction, if a California taxpayer received or earned a payment in violation of Section 409A, the individual would be subject to aggregate excise taxes at the rate of 40% (a 20% Federal excise tax plus a 20% California state excise tax) on that payment—in addition to ordinary federal and state income taxes. As a result of the reduction in the rate of California Section 409A excise taxes, the aggregate excise tax rate for a California taxpayer who receives or earns a payment in violation of Section 409A will be 25% (reflecting a 20% Federal excise tax and a 5% California state excise tax) instead of 40%.

Our related client publication is available at:

http://www.shearman.com/en/newsinsights/publications/2013/10/california-reduces-rate-of-section-409a-state-ex

Final Rules Implementing the Volcker Rule Issued

On 10 December 2013, the final rules implementing the Volcker Rule were published by the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), the SEC, the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC") and the Commodity Futures Trading Commission ("CFTC"). The final rules were developed jointly and implement Section 619 of the Dodd-Frank Act (known as the Volcker Rule). The Federal Reserve Board also announced that banking entities will need to comply with the Volcker Rule by 21 July 2015. Under the Volcker Rule, banking entities are prohibited from engaging in short-term proprietary trading of certain securities, derivatives, commodity futures and options on these instruments, for their own account. Limits are also imposed on banking entities' investments in, and other relationships with, hedge funds or private equity funds. There are exemptions for certain activities, including market making, underwriting, hedging, trading in government obligations, insurance company activities, and organising and offering hedge funds or private equity funds. In addition, certain activities are not prohibited, including acting as agent, broker, or custodian.

The Final Volcker Rule is available at:

http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210a1.pdf

Our client note, Volcker Unbound, is available at:

http://www.shearman.com/en/newsinsights/publications/2014/volcker-unbound

GLOBAL DEVELOPMENTS

HKEx – Revised Joint Policy Statement and Country Guides for Listing of Overseas Companies

Hong Kong regulators are continuing their efforts to attract listing of overseas companies. On 27 September 2013, the Securities and Futures Commission ("SFC") and The Stock Exchange of Hong Kong Limited ("Stock Exchange") published a revised Joint Policy Statement Regarding the Listing of Overseas Companies ("Revised JPS"). To facilitate implementation of the Revised JPS, the Stock Exchange published 20 Country Guides with regard to acceptable overseas jurisdictions on 20 December 2013.

Recognised Jurisdictions vs. Acceptable Jurisdictions

The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules") recognise Hong Kong, the People's Republic of China, Bermuda and the Cayman Islands as eligible places of incorporation for listed issuers ("Recognised Jurisdictions"). In addition, the Stock Exchange has approved, in principle, 21 jurisdictions of incorporation: Australia, Brazil, British Virgin Islands, Canada (Alberta), Canada (British Columbia), Canada (Ontario), Cyprus, England and Wales, France, Germany, Guernsey, Isle of Man, Italy, Japan, Jersey, Republic of Korea, Labuan, Luxembourg, Singapore, USA (California) and USA (Delaware) ("Acceptable Jurisdictions").

A listing applicant incorporated outside the Recognised Jurisdictions must demonstrate, to the satisfaction of the Stock Exchange, that it is subject to shareholder protection standards at least equivalent to those provided in Hong Kong, and will be assessed on the basis of:

- the criteria and standards set out in the Revised JPS; and
- where applicable, the relevant Country Guide in relation to the Acceptable Jurisdiction concerned.

The Revised JPS

To facilitate listing of overseas companies incorporated outside the four Recognised Jurisdictions, the SFC and the Stock Exchange issued a Joint Policy Statement Regarding the Listing of Overseas Companies on 7 March 2007 ("2007 JPS"). The 2007 JPS sets out a roadmap for overseas applicants by identifying the key shareholder protection standards expected of an acceptable jurisdiction. Since the issue of the 2007 JPS, the Stock Exchange has approved a wide range of Acceptable Jurisdictions and issued Listing Decisions to provide guidance for potential applicants from those jurisdictions.

The Revised JPS further streamlines and consolidates all relevant issues regarding primary and secondary listings of overseas companies in Hong Kong into one single document. Key elements of the Revised JPS include:

Shareholder Protection Standards

The Revised JPS refines the key shareholder protection standards that must be met, including (i) matters requiring super majority vote by shareholders, (ii) requirement for individual member's approval for any increase in the member's liability, (iii) members' approval for appointment and removal of auditors, and (iv) requirement to hold annual general meetings and matters relating to proceedings at general meetings.

An overseas applicant must demonstrate compliance with the key shareholder protection standards by a combination of domestic laws and regulations, its constitutional documents and other arrangements it has adopted.

Regulatory Cooperation Arrangements

The SFC and the Stock Exchange have expanded the regulatory cooperation expected to be in place with the overseas jurisdiction concerned. The statutory securities regulators of (i) the applicant's jurisdiction of incorporation; and (ii) the applicant's place of central management and control (if different) must both be full signatories of the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information ("IOSCO MMOU"), or have entered into an appropriate bi-lateral agreement with the SFC.

Acceptable Overseas Accounting and Auditing Standards

The Revised JPS sets out a list of overseas reporting standards that the Stock Exchange has accepted in the past, e.g. the Generally Accepted Accounting Principles in the United States of America ("US GAAP"), for dual listing in the US and Hong Kong, the Generally Accepted Accounting Practice in the UK ("UK GAAP"), and EU-IFRS (the IFRS as adopted by the European Union) for use by EU companies. Financial statements not adopting Hong Kong Financial Reporting Standards ("HKFRS") or International Financial Reporting Standards ("IFRS") must include a statement showing the financial effect of any material differences between the financial statements and financial statements prepared using HKFRS or IFRS.

An applicant may also apply from the Stock Exchange for a waiver for non-Hong Kong qualified reporting auditors. Generally, auditors that are not Hong Kong qualified would be considered acceptable if the firm (i) has an international reputation; (ii) is a member of a recognised body of accountants; and (iii) is subject to independent oversight by a regulatory body of a jurisdiction that is a signatory to the IOSCO MMOU.

Practical and Operational Matters

The Revised JPS provides guidance on practical or operational difficulties that an overseas listing applicant may encounter, e.g. conflicts between domestic laws and the Listing Rules, eligibility of securities for deposit, clearance and settlement in Central Clearing and Settlement System ("CCASS"), and cross-border clearing and settlement for dual-primary or secondary listed issuers.

Secondary Listing

The Revised JPS clarifies and simplifies the secondary listing regime in Hong Kong. A secondary listed issuer will principally be regulated by the rules and authorities of the jurisdiction where it is primary listed while a primary or dual-primary listed issuer will be subject to the full requirements of the Listing Rules.

Suitability for Secondary Listing

An overseas company that has its "centre of gravity" in the Greater China region will not be approved for secondary listing in Hong Kong. The Stock Exchange would expect the dominant market in the company's securities to be on an overseas exchange which meets the standards of shareholder protection at least equivalent to those provided in Hong Kong. In this connection, the Revised JPS recognises 15 overseas stock exchanges which meet the standards required under the Listing Rules ("Recognised Stock Exchanges"):

	Australian Securities Exchange	Brazilian Securities, Commodities and Futures Exchange
Frankfurt Stock Exchange	Italian Stock Exchange	London Stock Exchange
Madrid Stock Exchange	NASDAQ OMX	New York Stock Exchange
Paris Stock Exchange	Singapore Stock Exchange	Stockholm Stock Exchange
Swiss Exchange	Tokyo Stock Exchange	Toronto Stock Exchange

Waivers

The Stock Exchange has also codified its approach on granting waivers to overseas applicants seeking a primary, dual-primary or secondary listing in Hong Kong. In relation to secondary listing, the Revised JPS sets out extensive automatic waivers, e.g. waivers from notifiable and connected transactions requirements, waivers from the Code and requirements for share option schemes, for an issuer that meets the following criteria:

- primary listing on the main market of one of the Recognised Stock Exchanges;
- market capitalisation in excess of US$400 million;

- listing on its primary market for at least five years. This track record criterion does not apply if the applicant is well-established and has a market capitalisation that is significantly larger than US$400 million; and
- good compliance record with the rules and regulations of its home jurisdiction and primary market.

Country Guides

Except for Canada (Ontario), the Stock Exchange has issued a Country Guide for each of the Acceptable Jurisdictions. The Country Guides replace the Listing Decisions previously issued and serve as comprehensive guides on how companies incorporated in the relevant jurisdictions can meet the requirement for equivalent shareholder protection standards under the Revised JPS. The Country Guide for Canada (Ontario) will be issued at a later date when an applicant incorporated in Toronto applies for a listing in Hong Kong.

Where an applicant adopts the arrangements set out in the Country Guide for its place of incorporation, it will not be required to provide a detailed explanation of how it meets the key shareholder protection standards specified in the Revised JPS.

Full texts of the Revised JPS and the Country Guides are available at:

http://www.hkex.com.hk/eng/rulesreg/listrules/listsptop/listoc/Documents/new_jps_0927.pdf; and

http://www.hkex.com.hk/eng/rulesreg/listrules/listsptop/listoc/list_of_aoj.htm

EU DEVELOPMENTS

General Developments

Proposed Directive on Improving Gender Balance of Non-executive Directors of Listed Companies: Report and Adoption by Parliament

The proposed directive was supported by a joint report of the European Parliament Committees on Legal Affairs and Women Rights and Gender Equality, published on 14 October 2013, which confirmed the need for legislation to help increase numbers of female non-executive directors on listed company boards. The proposed directive was adopted, with amendments, by the European Parliament on 20 November 2013 and is still awaiting approval by the Council.

The key amendments to the Commission's proposed text included:

- increased detail on the selection process, including ensuring that the pool of candidates is gender balanced, in order to attain the 40% quota of non executive directors of the under represented sex;
- removing the exemption from the 40% quota, proposed by the Commission, for companies with a workforce comprised of less than 10% of the under-represented sex;
- new sanctions for non-implementation, including exclusion from public calls for tenders and restriction on funding available from the EU's structured funds;
- requiring annual statements about the implementation of the directive and any failure to attain the quota to be published in the annual report as well as on the company's website; and

- requiring the Commission, in its evaluation report (due by 1 July 2017), to examine whether the directive should be extended to include non-SME non-listed companies and executive directors of listed companies.

The Committees' Report is available at:

http://www.europarl.europa.eu/document/activities/cont/201310/20131030ATT73694/20131030ATT73694EN.pdf

The text of the proposed directive, as adopted by the Parliament is available at:

http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+20131120+SIT-03+DOC+WORD+V0//EN&language=EN

Amendment to the Transparency Directive

On 17 October 2013, the Council of the European Union adopted a directive to amend the so-called Transparency Directive. The text of the amendments is the same as that previously approved by the Parliament, except for minor technical points. The amending directive was published in the Official Journal on 6 November 2013 and came into force on 26 November 2013. Member States are required to implement its provisions within two years of it coming into force.

The amending directive is available at:

http://new.eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2013.294.01.0013.01.ENG

ESMA Publishes Versions 20 and 21 of Questions and Answers on Prospectuses

On 28 October 2013, the European Securities and Markets Authority ("ESMA") published version 20 of its Questions and Answers on Prospectuses. Three new questions have been added since the last version was published:

- "Agreement" of the independent accountant/auditor where a profit estimate is included in a prospectus without a report on it. This question relates to the possibility under the Prospectus Regulation not to include an independent accountants'/auditors' report on a profit forecast in a prospectus, where the relevant financial information relates to the previous financial year and only contains non-misleading figures substantially consistent with the final figures to be published in the next annual audited financial statements covering the previous financial year. In place of the report, there must, among other things, be included a statement that the accountants/auditors have agreed that the information is "substantially consistent" in this way. ESMA has clarified that any of the auditor, offeror, issuer or person seeking admission to trading may make the statement. ESMA also considers that the meaning of the statement is merely that "the auditors do not expect the figures to change substantially, except in case of unforeseen events" and can therefore be made with a lower level of assurance than the audit report.
- Proportionate disclosure regime for prospectuses for rights issues. There are two questions answered in relation to this issue:
  - If an offer to the public is made following an undersubscribed rights issue, this offer should be treated as separate and a prospectus drawn up just as if it were a normal offer to the public. Therefore, the proportionate disclosure regime does not apply unless the "public offer" exemptions under the Prospectus Directive are applicable.
  - A prospectus drawn up under the proportionate disclosure regime may also be used where any shares not subscribed for under the rights issue by existing shareholders or pre-emptive rights holders are offered to other investors where the "public offer" exemptions apply.

ESMA has also revised its answers on pro forma financial information and the level of disclosure concerning price information for share offerings, which both became effective from 28 January 2014.

Prospectuses Questions and Answers version 20 is available at:

http://www.esma.europa.eu/system/files/2013-1537_qa_prospectuses_-_20th_updated_version_0.pdf

On 15 January 2014, ESMA published a further version (no. 21) of its Questions and Answers on Prospectuses which contains answers to two new questions:

- The format for the individual summary in a prospectus relating to several securities. ESMA has provided two alternative formats that may be used for such a summary.
- Which registration document schedule—a share or a debt securities one—should be used where a listed issuer proposes to issue convertible or exchangeable debt securities and where the underlying securities to be issued on conversion are the issuer's shares. ESMA has said that where these underlying shares (and not just shares of the same class) are already issued and admitted to trading on a regulated market, a debt registration document can be used.

Prospectuses Questions and Answers version 21 is available at:

http://www.esma.europa.eu/content/QA-Prospectus-21st-version

Council Announces Audit Reforms

On 18 December 2013, the Council of the European Union issued a press release stating that it had reached agreement with the Parliament and the Permanent Representatives Commission on a legislative proposal to increase the credibility of audited financial statements of public-interest entities ("PIEs"). The key changes proposed include:

- mandatory rotation of auditors every 10 years, or every 24 years where the audit is carried out jointly between firms. Member States may extend the 10-year period to 20 years where the audit contract is publicly tendered;
- prohibition and restriction on the provision of non-audit services to the audited entity. Tax consultancy and advisory services will be prohibited, whilst other non-prohibited non-audit services provided over three years or more will have their fees limited to a maximum of 70% of the average of the fees paid in the last three years by the audited entity; and
- cooperation of audit oversight bodies, including a Committee of European Auditing Oversight Bodies (CEAOB) and ESMA to ensure guidance and supervision.

The press release is available at:

http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/140170.pdf

Ruling on Access to Prospectuses in Electronic Form

On 26 November 2013, Advocate General Sharpston gave an opinion in the case of *Michael Timmel v. Aviso Zeta AG* (Case C-359/12). In that case, a prospectus and related documents were only available to potential investors on a website following a complex registration process. Some of the documents were only accessible upon payment of a fee. The Advocate General concluded that such a restriction of access to a prospectus or base prospectus would be incompatible with Article 29 of the Prospectus Regulation, which implements the Prospectus Directive. Such documents should be easily accessible and should not require:

- payment of a fee;

- limitation to the number of documents viewed for free (in this case two per month); and
- registration involving agreeing to a disclaimer and providing an email address.

The Advocate General's opinion is available at:

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62012CC0359:EN:HTML

ESMA Publishes its Work Programme for 2014

According to its work programme, published on 3 October 2013, in 2014 ESMA intends to focus on the following areas:

- convergence – consolidation and co-operation of supervisory regimes, including ongoing discussion with the International Accounting Standards Board ("IASB") about developments in International Financial Reporting Standards ("IFRS") and maintaining Question & Answer documents under various pieces of legislation;
- financial consumer protection – product intervention, including bans of certain financial products by ESMA under the Markets in Financial Instruments Regulation ("MiFIR"); improving the application and implementation of the Markets in Financial Instruments Directive ("MiFID") conduct of business rules; drafting technical standards in relation to the Packaged Retail Investment Products initiative;
- financial stability – financial market surveillance and economic research;
- single rulebook – review of MiFID and the Market Abuse Directive ("MAD") including drafting implementing measures (see "*ESMA Consults on Implementing Measures under the New European Market Abuse Regime*" below); and
- supervision – of trade repositories and credit ratings agencies.

The work programme is available at:

http://www.esma.europa.eu/system/files/2013-1355_rev1_-_2014_work_programme.pdf

ESMA Publishes Final Report on Supplementary Prospectuses

On 20 December 2013, ESMA published its final report on draft regulatory technical standards ("RTS") on specific situations that require the publication of a supplement to the prospectus. ESMA's draft RTS now include an obligation to publish a supplement in the following circumstances:

- new annual audited financial statements are published;
- an existing profit forecast or a profit estimate is amended;
- change of control;
- new public takeover bid by third parties;
- change to the working capital statement;
- the issuer is seeking an additional listing in an additional country or an additional offer in another Member State;
- a new significant financial commitment is undertaken which is likely to give rise to a significant gross change; and
- aggregate nominal amount of the offering programme is increased.

The Commission has three months, from 20 December 2013, to decide whether to endorse the draft regulatory technical standards.

The report is available at:

http://www.esma.europa.eu/system/files/2013-1970_report_on_draft_rts_for_supplements_to_prospectuses.pdf

Financial Markets Regulation Developments

European Trade Rporting Start Date

On 7 November 2013, ESMA announced that the reporting start date for all derivative asset classes—commodities, credit, FX, equity, interest rates and others—would be 12 February 2014. The date has been set following the approval for registration by ESMA of four trade repositories, the registrations of which took place on 14 November 2013. The European Commission published a communication on the same date announcing that it would not endorse ESMA's request for a delay to the reporting start date of exchange traded derivatives ("ETDs"). In August 2013, ESMA submitted draft implementing technical standards to the Commission for endorsement to delay the reporting start date of ETDs to January 2015. ESMA considered that it needed time to develop guidelines and recommendations to ensure consistent application of the reporting obligation for ETDs under the European Market Infrastructure Regulation (EU) No. 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties ("CCPs") and trade repositories ("EMIR"). The Commission considered that the delay was not justified and would go against the principle of ensuring the stability of the financial system.

Final Draft RTS on Extraterritorial Effect of Risk Mitigation Obligations under EMIR

On 18 November 2013, ESMA published its final draft RTS on contracts with a direct, substantial and foreseeable effect within the EU and non-evasion of the provisions of EMIR. The draft RTS provide (i) that the clearing obligation and risk mitigation provisions under EMIR also apply to contracts between two non-EU counterparties where those contracts have a direct, substantial and foreseeable effect within the EU; and (ii) for the prevention of the evasion of rules or obligations under EMIR.

The European Commission has until 15 February 2014 to decide whether to endorse the draft RTS. If endorsed, the RTS will still be subject to the consent of the European Parliament and Council before they can come into force. To allow market participants time to adapt to the new requirements for contracts considered to have a direct, substantial and foreseeable effect within the EU, ESMA proposes to delay the application of that provision for six months. The non-evasion provision would come into force 20 days after publication of the RTS in the Official Journal.

The draft RTS are available at:

http://www.esma.europa.eu/system/files/2013-1657_final_report_on_emir_application_to_third_country_entities_and_non-evasion.pdf

Delegated Regulations under EMIR

On 19 October 2013, the following two delegated regulations were published in the European Union Official Journal:

Commission Delegated Regulation (EU) No. 1002/2013 of 12 July 2013 amending EMIR with regard to the list of exempted entities. This Regulation provides that EMIR is not applicable to the central banks and public bodies charged with or intervening in the management of the public debt in the US and Japan. The Regulation came into effect on 8 November 2013.

The Delegated Regulation is available at:

http://new.eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=oj:JOL_2013_279_R_0002_01&from=EN

Commission Delegated Regulation (EU) No. 1003/2013 of 12 July 2013 supplementing Regulation (EU) No. 648/2012 of the European Parliament and of the Council with regard to fees charged by ESMA to trade repositories. The Regulation came into effect on 22 October 2013.

The Delegated Regulation is available at:

http://new.eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=oj:JOL_2013_279_R_0004_01&from=EN

ESMA Publishes Further Third Country Advice on Equivalence

On 2 October 2013, ESMA published technical advice to the European Commission on the equivalence to the rules under EMIR of the derivative rules in South Korea, India and Canada, as well supplemental advice to its advice on Australia, Hong Kong and Switzerland. The scope of the advice covers requirements for CCPs and trade repositories, requirements for the clearing obligation, reporting obligation, non-financial counterparties, and risk mitigation techniques for uncleared trades. The European Commission is responsible for adopting implementing acts on equivalence for each jurisdiction.

ESMA's technical advice is available at:

http://www.esma.europa.eu/news/ESMA-delivers-second-set-advice-EMIR-equivalence?t=326&o=home

European Commission Reports on Impact of Short Selling Regulation

On 13 December 2013, the European Commission published its report to the European Parliament and to the Council of the European Union on the impact of the Short Selling Regulation (the "SSR"). The Commission concludes that the SSR has had a positive impact in terms of greater transparency of short sales and reduced settlement failures. The Commission does not consider that there is sufficient evidence yet to warrant a revision of the SSR.

The report is available at:

http://ec.europa.eu/transparency/regdoc/rep/1/2013/EN/1-2013-885-EN-F1-1.Pdf

European Political Agreement on Reached Proposed Directive for Market Abuse

On 20 December 2013, the Council of the European Union announced that political agreement had been reached on the proposed Directive on criminal sanctions for insider dealing and market manipulation ("CSMAD"). Under CSMAD, Member States must enact laws domestically for criminal penalties for insider dealing, market manipulation and unlawful disclosure of inside information. The agreement means that CSMAD and the proposed Regulation on insider dealing and market manipulation (Market Abuse Regulation, or "MAR") can be adopted at first reading by the European Parliament. MAR is still subject to technical amendments pending the finalisation of the new Markets in Financial Instruments Regulation and Directive ("MiFID II").

The press release is available at:

http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/140276.pdf

ESMA Consults on Implementing Measures under the New European Market Abuse Regime

On 14 November 2013, ESMA published a discussion paper proposing positions and regulatory options on implementing measures it will be required to develop for the new MAR. The proposals are based on the text agreed by the European Parliament, European Commission and the Council on 24 June 2013. The final version of MAR is still to be published in the Official Journal, which is being delayed pending the finalisation of MiFID II. ESMA's discussion paper covers issues such as indicators and signals of market manipulation, format for insider lists, criteria to establish accepted market practices and reporting of violations and related procedures. Responses to the proposals were requested through 27 January 2014. Responses will be taken into account when ESMA prepares the draft technical standards and advice required under MAR. The timing of ESMA's publication of those later consultations will depend on the publication of the final version of MAR.

The discussion paper is available at:

http://www.esma.europa.eu/content/ESMA%E2%80%99s-policy-orientations-possible-implementing-measures-under-Market-Abuse-Regulation

ESMA Provides Clarification on the Meaning of "Acting in Concert"

On 12 November 2013, ESMA published a public statement which aims to provide clarification to investors on the meaning of "acting in concert" as defined in the Takeover Bid Directive. The statement is made in response to the European Commission's report in 2012 in which it recommended that clarification was needed to increase certainty for international investors who wish to cooperate with each other on corporate governance issues but may feel inhibited from doing so in case that action would result in them having to make a mandatory bid. The statement represents the collective views of ESMA and the national authorities that implement the Takeover Bid Directive. The statement includes a "White List" of activities that an investor may cooperate in and which would not be considered as "acting in concert" and therefore the investor would not be required to make a mandatory bid. The statement emphasises that the circumstances of each case will still need to be assessed by national regulators and that early consultation with regulators is very important. ESMA will keep the statement under review to ensure that it continues to reflect the practices and views of the applicable regulators.

ESMA's public statement is available at:

http://www.esma.europa.eu/system/files/2013-1642_esma_public_statement_-_information_on_shareholder_cooperation_and_acting_in_concert_under_the_takeover_bids_directive.pdf

European Commission Responds to IOSCO on CCP Recognition

On 22 December, the International Organisation of Securities Commissions (IOSCO) published the response from the European Commissioner, Michel Barnier, to its letter seeking clarification from the European Commission about the approach to equivalence assessments under EMIR for CCPs. The Commission states that it is analysing the advice provided by ESMA on the equivalence of various third country regimes which involves assessing whether, despite differences in the legal and supervisory regimes, similar outcomes are achieved, namely the reduction of systemic risk in financial markets. With regard to the link between the recognition process for central counterparties and the treatment of

CCP exposures under the Capital Requirements Regulation (CRR), the Commission confirms that it will consider extending the deadline if necessary.

A copy of the letter from the European Commission is available at:

http://www.iosco.org/committees/aprc/pdf/20131220_Response_from_EU_to_APRC_letter.pdf

EBA Warning on Virtual Currencies

On 12 December 2013, the European Banking Authority (the "EBA") published a warning to consumers buying, holding or trading virtual currencies such as Bitcoin. The EBA warns consumers that there are no specific regulatory protections that would cover a consumer for losses if a platform that exchanges or holds virtual currencies fails or goes out of business. Consumers are expected to familiarise themselves with the risks associated with virtual currencies. The EBA is, in the meantime, assessing whether virtual currencies can and should be regulated.

ESAs Publish Joint Position on Product Oversight

The European Supervisory Authorities, EBA, ESMA and the European Insurance and Occupational Pensions Authority (the "EIOPA") (together, the "ESAs") published, on 28 November 2013, a joint position paper setting out high-level principles on product oversight and governance processes within financial institutions. The principles represent an agreement among the ESAs upon which each ESA may develop more detailed provisions for their sector at a later stage. Those detailed provisions will be directed at financial institutions and/or national regulators.

The position paper is available at:

http://www.eba.europa.eu/documents/10180/15736/JC-2013-77+%28POG+-+Joint+Position%29.pdf

ESMA Publishes Information on Waivers from Pre-trade Transparency

On 18 December 2013, ESMA published a document discussing the waivers from pre-trade transparency under Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on MiFID. Under MiFID, operators of regulated markets ("RMs") and multilateral trading facilities ("MTFs") must make public the current bid and offer prices and the depth of trading interests in respect of shares admitted to trading on a regulated market unless exemptions apply. RMs and MTFs must apply to their national regulator for an exemption. With the publication of this document, ESMA aims to assist regulators to meet the opinions that ESMA expresses on this issue in the exemption process. The information also provides clarity to market participants on the MiFID requirements.

ESMA Reports on Deficiencies in Credit Rating Agencies Sovereign Ratings Processes

On 2 December 2013, ESMA published a report identifying numerous deficiencies in the processes for producing and issuing sovereign ratings at Fitch Ratings, Moody's Investors Service and Standard & Poor's. ESMA investigated the sovereign rating processes at the three credit rating agencies (the "CRAs") between February 2013 and October 2013. Problems were identified on the independence and avoidance of conflicts of interests, confidentiality, timing of publications of rating actions and resources. ESMA, as supervisor of the CRAs, is requiring them to address the issues and will monitor progress on the remedial actions. ESMA has not yet determined whether there has been a breach of the CRA Regulation and may take appropriate action in due course.

The report is available at:

http://www.esma.europa.eu/news/Press-Release-ESMA-identifies-deficiencies-CRAs-sovereign-ratings-processes

ESMA Publishes Market Share of CRAs

On 16 December 2013, ESMA published the market share of CRAs registered within the EU as of 12 December 2013. Total market share is calculated according to the annual turnover generated from credit rating activities and ancillary services, at the group level. The annual turnover is for 2012. The CRA Regulation requires ESMA to publish the EU's CRA's market share once a year. Issuers who intend to appoint at least two CRAs for the credit rating of the same issuance or entity are required to consider appointing at least one CRA with no more than 10% of the total market share.

ESAs Consult on Removing Mechanistic References to Credit Ratings

The ESAs are consulting on the approach to mechanistic references to credit ratings in their guidelines and recommendations. Under the European CRA Regulation, the ESAs may not refer to credit ratings in their guidelines, recommendations and draft technical standards where such reference has the potential to trigger sole or mechanistic reliance on credit ratings by national regulators and financial market participants and must review and remove such references by 31 December 2013. The consultation includes proposals to amend various guidelines including under the new capital requirements legislation and on money market funds. Responses to the consultation were due by 5 December 2013.

The consultation paper is available at:

http://www.eba.europa.eu/documents/10180/478213/JC-CP-2013-02+%28Mechanistic+References+to+Credit+Ratings%29.pdf

ESMA's Technical Advice on the Feasibility of a Network of Small- and Medium-sized CRAs

On 21 November 2013, ESMA published its technical advice to the European Commission on the feasibility of a network of small and medium-sized CRAs. The European Commission was obligated to report under the European CRA Regulation by the end of 2013 on this issue in order to promote competition in the market. ESMA's advice includes information on all registered and certified CRAs, particularly on small and medium-sized CRAs in the EU, as well as potential barriers to entry for companies that want to conduct rating activities in the EU.

ESMA's technical advice is available at:

http://www.esma.europa.eu/system/files/2013-1703_technical_advice_on_the_feasibility_of_a_network_of_small_and_medium-sized_cras_0.pdf

DEVELOPMENTS SPECIFIC TO FINANCIAL INSTITUTIONS

Global Developments

G30 Report Calls for New Paradigm in Relations between Banking Supervisors and Bank Boards of Directors

On 28 October 2013, the G30 published a report titled "A New Paradigm – Financial Institution Boards and Supervisors." The report sets out four actions that the G30 considers necessary to improve governance and risk management in systemically important financial institutions and other financial institutions:

- Development of trust-based interaction between boards and regulators based on clear mutual expectations with a focus on examining business model vulnerabilities, governance effectiveness and culture.
- Boards must recognise that supervisory interaction takes time and good preparation, and they must adopt a proactive mindset.
- Supervisors must set out their objectives clearly and be knowledgeable about sound governance practices.
- National governments must recognise the need for stature and adequate resources and staffing for prudential regulators.

The report is available at:

http://www.group30.org/images/PDF/Banking_Supervision_CG.pdf

FSB Publishes Global Shadow Banking Monitoring Report for 2013

On 14 November 2013, the FSB published its Global Shadow Banking Monitoring Report 2013. The report includes the results of the third annual monitoring exercise using end-2012 data and includes data from 25 jurisdictions and the Euro area as a whole, bringing the coverage of the monitoring exercise to about 80% of global GDP and 90% of global financial system assets. The report presents the size and growth trends of the shadow banking system, cross-jurisdiction analysis, trends in sub-sectors and interconnectedness with the banking system. In addition, the report includes new and emerging trends identified in the non-bank financial system, such as direct lending by non-banks (e.g. insurance companies, pension funds, private equity funds) to non-financial corporates and various regulators' case studies including from the UK, the US and South Africa. The report finds that (i) non-bank financial intermediation grew in 2012; (ii) emerging market jurisdictions showed the most rapid increases in non-bank financial system assets; and (iii) that there was no sizeable change in the level of interconnectedness between the banking and the non-bank financial system in 2012. The FSB notes that the monitoring exercise will improve going forward as data availability and granularity improves.

The FSB report is available at:

http://www.financialstabilityboard.org/publications/r_131114.pdf

Basel Committee's Survey of Liquidity Stress Testing

On 23 October 2013, the Basel Committee published a survey of theory, empirics and current industry and supervisory practices of liquidity stress testing. Key messages emerging from the survey are (i) adequately designed and properly implemented liquidity stress tests can provide valuable information on a bank's liquidity profile that is not available from liquidity metrics; (ii) regulators have a critical role in conducting system-wide liquidity stress tests because banks generally lack the data and often use diverse assumptions; (iii) horizontal stress tests are desirable but best practice for regulators is still to emerge; (iv) it is recommended that regulators apply both bottom-up and top-down approaches in conducting horizontal stress tests to capture second-round and systemic effects; (v) regulators should consider, where appropriate, (a) evaluating a bank's liquidity position on a currency-by-currency basis for those currencies in which it is most active, (b) whether a bank's interaction with the shadow banking system warrants attention, and (c) a bank's group structure in terms of legal entities subject to different regulatory regimes vs. consolidated group. The survey concludes that assumptions regarding a central bank's support for the financial system in a crisis should be limited. It is also recommended that liquidity and solvency risks should be considered part of an integrated exercise and that regulators' expectations regarding the integration of liquidity stress testing results into a bank's business practice should be clear.

The survey is available at:

http://www.bis.org/publ/bcbs_wp24.pdf

Basel Committee Consults on the Fundamental Review of the Trading Book

On 31 October 2013, the Basel Committee published a second consultation on the fundamental review of capital requirements for the trading book which includes detailed proposals for a revision of the market risk framework. This consultation takes into account responses to the first consultation, issued in May 2012. Responses to the consultation were due by 31 January 2014.

The consultation is available at:

http://www.bis.org/publ/bcbs265.pdf

Basel Revised Policy for Banks' Equity Investments in Funds

On 13 December 2013, the Basel Committee published a final policy framework entitled "Capital requirements for banks' equity investments in funds." The final policy revises the prudential treatment of banks' investments in the equity of funds within the Basel risk-based capital framework and is scheduled to take effect from 1 January 2017. The revised policy will apply to banks' equity investments in all funds (e.g. hedge funds, managed funds and investment funds) that are not held for trading purposes.

The final policy framework document is available at:

http://www.bis.org/publ/bcbs266.pdf

FSB Updates List of G-SIBs

On 11 November 2013, the FSB published the annual update of the list of global systemically important banks ("G-SIBs"), using end-2012 data. Industrial and Commercial Bank of China Limited is the only bank added to the list of G-SIBs. In conjunction with the publication of the updated list, the Basel Committee published additional information on the methodology for identifying G-SIBs which is: (i) the denominators that were used to calculate the scores of banks in the end-2012 exercise; and (ii) the cut-off score and bucket thresholds that were used to identify the updated list of G-SIBs and to allocate them to buckets. The information has been published to enable G-SIBs to calculate their end-2012 scores and see their positions within the buckets which will determine their higher loss absorbency ("HLA") requirement. The HLA requirements start to come into effect on 1 January 2016, based on end-2013 data.

The list of G-SIBs is available at:

http://www.financialstabilityboard.org/publications/r_131111.pdf

The information on identifying G-SIBs is available at:

http://www.bis.org/publ/bcbs255.pdf

Consultation on Public Disclosure Standards for CCPs

On 15 October 2013, the Committee on Payment and Settlement Systems ("CPSS") and IOSCO published a consultation paper on proposed public quantitative disclosure standards for CCPs. Under the CPSS-IOSCO Principles for financial market infrastructures, financial market infrastructures should provide information to participants, authorities and the public which allows for a proper assessment of the risks of participating in the system. The proposals include a common set of basic data on transaction volumes and values and a common minimum set of quantitative information on the CCP's financial condition, resources and performance and envisage the use of a common template. Comments on the draft disclosure standards were due by 13 December 2013. The proposals should be read in conjunction with the CPSS-IOSCO Disclosure Framework and Assessment Methodology of December 2012.

The consultation paper is available at:

http://www.bis.org/publ/cpss114.pdf

Basel Committee Report on Regulatory Consistency of Risk-Weighted Assets

On 17 December 2013, the Basel Committee published its second report on the regulatory consistency of RWAs for market risk in the trading book. The study is a part of its wider Regulatory Consistency Assessment Programme, which is intended to ensure consistent implementation of the Basel III framework. The Report indicates that there are significant variations in the outputs of market risk internal models used to calculate regulatory capital and that variability typically increases for more complex trading positions.

The report is available at:

http://www.bis.org/publ/bcbs267.pdf

FSB Consults on Draft Guidance on Supervisory Interaction with Financial Institutions on Risk Culture

On 18 November 2013, the Financial Stability Board ("FSB") published, for consultation, draft guidance which aims to assist regulators in identifying core practices and attitudes that may be indicative of an institution's risk culture. The draft guidance explores ways that regulators can formally assess risk culture in financial institutions, with a particular focus on systemically important financial institutions.

The consultation document is available at:

http://www.financialstabilityboard.org/publications/c_131118.pdf

EU Developments

European Legislators Reach Agreement on Bank Recovery and Resolution

On 12 December 2013, the Council of the European Union and the European Parliament announced that they had reached a political agreement on the proposed recovery and resolution directive for banks (the "BRRD"). The BRRD will still need to be finalised technically but the legislators envisage that it will come into force in 2015, with the bail-in regime having come into force in January 2016.

The European Parliament's press release is available at:

http://www.europarl.europa.eu/pdfs/news/expert/infopress/20131212IPR30702/20131212IPR30702_en.pdf

Single Supervisory Mechanism for Banking Approved

On 15 October 2013, the Council of the European Union announced that it had adopted two regulations that create a single supervisory mechanism (the "SSM") for the prudential oversight of banks in the Eurozone. The European Central Bank ("ECB") and Member State regulators will make up the SSM, which is the first step in the creation of Europe's banking union. The ECB will have direct oversight of Eurozone banks in cooperation with national regulators. Member States not in the Eurozone can opt into the SSM. The ECB will assume its supervisory role one year after the entry into force of the new Regulations. The Regulations come into force once published in the European Official Journal.

The announcement is available at:

http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ecofin/139012.pdf

European Political Agreement Reached on Deposit Guarantee Schemes

On 17 December 2013, the European authorities announced that political agreement had been reached on the revised Deposit Guarantee Schemes Directive. The aim of the directive is to ensure sufficient financial means in the Deposit Guarantee Scheme funds and fast pay-outs to depositors. Each Member State must set up its own fund and each fund must reach an amount equal to 0.8% of the deposits covered within 10 years. The revised Directive is still subject to final technical amendments. Member States will be required to transpose the revised Directive into their national laws within 12 months of it coming into force.

The press release is available at:

http://www.europarl.europa.eu/pdfs/news/expert/infopress/20131217IPR31137/20131217IPR31137_en.pdf

European Political Agreement Reached on Central Securities Depositories Regulation

On 18 December 2013, the European Authorities announced that political agreement had been reached on the new Regulation on central securities depositories (the "CSD Regulation"). The CSD Regulation will establish a common authorisation, supervision and regulatory framework for central securities depositories. In addition, the securities settlement process will be improved through the introduction of a dematerialisation requirement, harmonisation of the settlement period and determination of settlement discipline measures. The CSD Regulation is still subject to finalisation through technical amendments. Once it comes into force, it will be applicable across the EU.

The press release is available at:

http://www.eu2013.lt/en/news/pressreleases/lithuanian-presidency-reaches-political-agreement-on-the-regulation-on-central-securities-depositories

ESMA and EBA Propose Complaints-Handling Guidelines for Securities and Banking Sectors

ESMA and the EBA published, on 6 November 2013, a proposal to adapt the EIOPA Guidelines on Complaints-Handling by Insurance Undertakings for the securities and banking sectors. The proposed guidelines would apply to investment firms, management companies, alternative investment fund managers, banks, payment institutions and electronic money institutions. With the proposed guidelines, ESMA and the EBA are seeking to clarify expectations of firms for complaints-handling, provide guidance on the provision of information to complainants and on procedures for responding to complainants, ensure the adequate protection of consumers including by harmonising the arrangements of firms for handling complaints and ensure that such arrangements are subject to a minimum level of supervisory convergence across the EU. Responses to the consultation were invited through 7 February 2014.

Guidelines on Remuneration Policies and Practices under MiFID

On 1 October 2013, ESMA published a final report on the proposed guidelines on remuneration policies and practices under MiFID. The report sets out the authority's feedback to responses to the consultation paper issued in September 2012, as well as the final guidelines. The aim of the guidelines is to ensure the consistent and improved implementation of the existing MiFID conflicts of interest and conduct of business requirements in the area of remuneration. The guidelines apply to investment firms, including banks, UCITS (Undertakings for Collective Investment in Transferable Securities) management companies and alternative investment fund managers ("AIFMs") when providing investment services. The guidelines also apply to national regulators. The guidelines will come into effect 60 days after the guidelines are published in the EU official languages on the ESMA website.

EBA Report on High Earners

On 28 November 2013, the EBA published its report on high earners. The report is required under the current Capital Requirements Directive III, which will be replaced from 1 January 2014 with the new CRD IV. The report collates the information collected by national regulators on the number of individuals in banks in pay brackets of at least €1 million in 2012.

Implementing Regulation on Own Funds Disclosure Published in Official Journal

On 31 December 2013, Commission Implementing Regulation (EU) No. 1423/2013 of 20 December 2013 laying down ITS with regard to disclosure of own funds requirements for institutions according to CRR was published in the European Official Journal. The Regulation applies from 31 March 2014.

The Regulation is available at:

http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:355:0060:0088:EN:PDF

EBA Publishes Further Final Draft Technical Standards under CRD IV

The EBA published the following final draft RTS and ITS:

- RTS on criteria to identify categories of staff whose professional activities have a material impact on an institution's risk profile and who would therefore be subject to the remuneration requirements under CRD IV such as the payment of variable remuneration.
- RTS specifying the conditions for assessing the materiality of extensions and changes of internal approaches for credit and operational risk.
- RTS which define the conditions and methodologies used to determine the overall exposure to a transaction with underlying assets and the risks inherent in the structure of the transaction itself.
- ITS on reporting for asset encumbrance, which aim to provide regulators with a standardised and harmonised framework for reporting of asset encumbrances in institutions. Large institutions (with assets above €30 billion) must begin reporting on asset encumbrance by 30 June 2014. All other institutions must begin reporting by 31 December 2014. The EBA will be consulting in the next few months on guidelines on asset encumbrance disclosure.
- RTS on the close correspondence between the fair value of an institution's covered bonds and the fair value of its assets. The draft RTS specify the criteria for defining the close correspondence between the fair value of the covered bonds and the fair value of the assets for the purpose of calculating capital requirements.
- RTS on the information required to be provided to national regulators when a bank wishes to establish a branch or provide services in another Member State (i.e. the passporting regime). The draft RTS also specify the information needed for changes in the branch notification, including termination of a branch operation.
- ITS on the forms, templates and procedures to be used when passport notifications are made.
- ITS setting out the uniform conditions of application of the joint decision process on capital and liquidity between consolidating supervisors and relevant national regulators. The draft ITS aim to facilitate the interaction and cooperation between the consolidating supervisor and the national regulators responsible for the supervision of EU subsidiaries of an EU parent institution, an EU parent financial holding company or an EU parent mixed financial holding company in a Member State.
- RTS on securitisation retention rules and ITS on the convergence of supervisory practices related to the implementation of additional risk weights in the case of non-compliance with the retention rules.
- RTS on the definition of materiality thresholds for specific risk in the trading book which set out criteria for assessing when the specific risk of debt instruments in the trading book—both at a solo and consolidated level—is 'material' enough to trigger an evaluation by a regulator.
- ITS on appropriately diversified indices which list relevant exchange-traded and appropriately diversified indices for which specific risk can be ignored.
- ITS on closely-correlated currencies which identify a list of relevant closely-correlated currencies for the purposes of calculating the capital requirements for foreign-exchange risk according to the standardised rules.
- RTS on non-delta risk of options in the standardised market risk approach which define a range of methods to reflect, in the own funds requirements, all the risks, other than delta risk, in a manner proportionate to the scale and complexity of institutions' activities in options and warrants.

- ITS on metrics for monitoring additional liquidity which provide regulators with an adequate toolkit to assess the liquidity risk profile of institutions. It is proposed that the ITS will apply from 1 July 2015.
- RTS on the definition of market to be applied for the calculation of the overall net position in equity instruments under the market risk standardised rules.
- RTS on the credit valuation adjustment risk for the determination of a proxy spread and the specification of a limited number of smaller portfolios. The EBA has also published an opinion which gives reasons for the adoption of a flexible approach by the EBA in these final draft RTS.
- RTS on the method for the identification of the geographical location of the relevant credit exposures which aim to ensure a consistent EU-wide implementation of the countercyclical buffer to protect against excess credit growth.
- ITS on supervisory disclosure which specify the format, structure, contents list and annual publication date of the supervisory information to be disclosed by national regulators.
- ITS on the reporting of the hypothetical capital of a CCP which specify calculations, reporting frequencies and templates for the information relating to hypothetical capital that a CCP has to deliver to all the banks and investment firms that are clearing members for the purpose of calculating their own capital requirements.
- RTS and ITS on information exchange between home and host regulators regarding branches and service providers which specify the information that regulators will exchange with each other under CRD IV. The standards cover management and ownership, liquidity and supervisory findings, solvency, deposit guarantee schemes, limitation of large exposures and internal control mechanisms.

The final draft RTS and ITS have been sent to the European Commission for endorsement. Once endorsed and published in the Official Journal, the standards will be directly applicable across the EU.

EBA Consults on Draft Technical Standards under CRD IV

The EBA is consulting on draft RTS and ITS required under CRD IV:

- on own funds which aim to set harmonised criteria for instruments with multiple distributions that would create a disproportionate drag on capital. The draft RTS also clarify the meaning of preferential distribution. This is part four of the EBA's consultation on own funds. The first three consultations are closed and final draft RTS have been submitted to the European Commission for endorsement. Responses to this fourth consultation were due by 24 January 2014. The EBA is expected to submit these draft RTS to the Commission by 1 April 2014.

The consultation paper is available at:

http://www.eba.europa.eu/documents/10180/498162/EBA-CP-2013-43+%28Consultation+on+Own+Funds+Part+IV%29.pdf

- on its proposed (i) draft RTS on the methodology for the identification of global systemically important institutions ("G-SIIs") which set out consistent parameters and specify a harmonised methodology for identifying G-SIIs and determining adequate levels of own funds across the EU; (ii) draft ITS which define uniform disclosure requirements to publicise the values used for the identification and scoring process for G-SIIs; and (iii) draft Guidelines on disclosure of indicators of global systemic importance and which propose to apply the same disclosure requirements to large institutions with an overall exposure of more than €200 billion and which are potentially systemically relevant. Under the Capital Requirements Directive national regulators must identify European banks representing a higher risk for the global financial system as G-SIIs, taking into account the framework by the FSB and the Basel Committee. Higher own funds requirements will apply to G-SIIs. Responses to the consultation are due by 28 February 2014. The draft RTS must be submitted to the Commission by 30 June 2014, and the draft ITS by 1 July 2014.

The consultation paper is available at:

http://www.eba.europa.eu/documents/10180/520579/EBA-CP-2013-44+%28CP+on+draft+RTS+on+G-SII+identification+ITS+and+GL+on+G-SII%29.pdf

- on disclosure for leverage ratio which aims to provide financial institutions subject to the CRR with uniform templates and instructions. Comments on the proposals are due by 24 January 2014. The EBA is expected to submit final draft ITS on disclosure for leverage ratio to the European Commission by 30 June 2014. Under CRR, the Commission has the power to change the calculation of the leverage ratio before 1 January 2015, which is before the duty to disclose begins. Therefore, the proposed templates and instructions may change before they are finally adopted by the Commission.

The consultation is available at:

http://www.eba.europa.eu/documents/10180/459196/EBA+CP+2013+41+%28Draft+CP+on+draft+ITS+on+disclosure+of+leverage+ratio%29.pdf

- on liquidity requirements, including (i) draft ITS on currencies for which the justified demand for liquid assets exceeds their availability; (ii) draft RTS on derogations for eligible currencies; and (iii) draft ITS listing the currencies for which the justified demand for liquid assets exceeds their availability. The EBA must submit the final draft ITS and RTS to the European Commission by 31 March 2014.

Information on the consultations is available at:

http://www.eba.europa.eu/-/eba-consults-on-draft-technical-standards-related-to-liquidity-requirements

Delay to European Technical Standards under CRD IV

On 7 October 2013, the EBA announced that the European Commission had agreed to the following revised deadlines for the submission of technical standards which the EBA is responsible for preparing under CRD IV:

- Article 105(14) CRR – RTS on prudent valuation: 1 June 2014;
- Article 28(5) CRR – RTS on multiple distribution for own funds: 1 April 2014;
- Article 36(2) CRR – RTS on specific deductions from own funds: 1 January 2014;
- Article 73(7) CRR – RTS on broad market indices for own funds: 1 January 2014;
- Article 84(4) CRR – RTS on calculation of minority interests for own funds: 1 January 2014; and
- Article 100 CRR – ITS on asset encumbrance reporting: 1 November 2013.

EBA Publishes Reports on Liquidity

The EBA published, on 20 December 2013, two reports on liquidity, namely the Report on appropriate uniform definitions of extremely high-quality liquid assets and high-quality liquid assets and on operational requirements for liquid assets and the Report on impact assessment for liquidity measures. Under CRD IV, the EBA is mandated to develop draft RTS or ITS as well as guidelines and reports related to liquidity in order to enhance regulatory harmonisation in

Europe through the Single Rulebook. The Reports have been passed to the European Commission, which is due to adopt its delegated regulation on these issues by 30 June 2014.

EBA Consults on Draft Guidelines on Disclosure of Encumbered and Unencumbered Assets

On 20 December 2013, the EBA launched a consultation on draft Guidelines on the disclosure of encumbered and unencumbered assets. The proposed Guidelines include three disclosure templates that firms will have to fill in as well as additional information about the importance of encumbrance in their individual funding model. The EBA is mandated under CRD IV to develop guidelines on unencumbered assets, taking into account the European Systemic Risk Board Recommendation of 20 December 2012 on funding of credit institutions. The consultation closes on 20 March 2014.

The draft Guidelines are available at:

http://www.eba.europa.eu/documents/10180/534767/EBA-CP-2013-48+%28Disclosure+of+asset+encumbrance%29.pdf

EBA Consults on Draft Guidelines for Funding Plans of Banks

The EBA published, on 20 December 2013, its consultation on draft Guidelines proposing harmonised definitions and templates for funding plans of banks which aim to harmonise the way funding plans are reported. It is envisaged that the final Guidelines will apply to banks and national regulators from 1 July 2014. Responses to the consultation are due 20 March 2014.

The draft Guidelines are available at:

http://www.eba.europa.eu/documents/10180/533694/EBA-CP-2013-47+%28on+GL+on+Funding+Plan+Templates%29.pdf

EBA Publishes Proposals for the Assessment of Liquidity and Funding Risk

The EBA launched, on 19 December 2013, proposals on the methodology for assessment of liquidity and funding risk under the supervisory review and evaluation process ("SREP"). The discussion paper includes the EBA's proposal for the common methodology and process for assessing liquidity and funding risk that will be part of the final overall SREP guidelines. The EBA has published the paper with the aim of helping national regulators and colleges of supervisors to reach a joint decision on liquidity for the first time in 2014. Responses were due by 28 January 2014.

The proposals are available at:

http://www.eba.europa.eu/documents/10180/532313/EBA-DP-2013-04+%28%20DP+on+the+draft+methodology+for+assessment+of+liquidity+and+funding+risk%29.pdf

EBA Publishes Technical Advice on Possible Treatments of Unrealised Gains

On 19 December 2013, the EBA published its technical advice and recommendations, as mandated under CRD IV, to the European Commission on possible treatments of unrealised gains measured at fair value other than including them in Common Equity Tier 1 without adjustment. The CRR prohibits institutions from making adjustments to remove from their own funds unrealised gains or losses on their assets or liabilities measured at fair value.

The technical advice is available at:

http://www.eba.europa.eu/documents/10180/16160/EBA-Op-2013-03+Technical+advice+on+treatment+of+unrealised+gains.pdf

ECB Announces Comprehensive Assessment Exercise for Large Eurozone Banks

On 23 October 2013, the ECB announced that a comprehensive assessment of the largest Eurozone banks will begin in November 2013 and be completed by October 2014 in preparation of the ECB assuming its supervisory role under the SSM. The assessment will consist of (i) a supervisory risk assessment to review risks such as liquidity, leverage and funding; (ii) an asset quality review; and (iii) a stress test. The assessment will be carried out in collaboration with national regulators and the EBA. The SSM was adopted on 15 October 2013, but formal publication in the Official Journal has not yet taken place to bring the two establishing regulations into force. On 21 October 2013, the EBA published recommendations for EU national regulators for existing or planned work on asset quality reviews, including the work of the SSM. The EBA recommends, amongst other things, that national regulators apply the common definitions on 'non-performing exposures' and 'debt forbearance' included in the final draft technical standards on supervisory reporting that the EBA also published on 21 October 2013. The final draft technical standards will need to be adopted by the European Commission before becoming directly applicable across the EU.

The ECB announcement is available at:

http://www.ecb.europa.eu/pub/pdf/other/notecomprehensiveassessment201310en.pdf?8e62306f6b4142b9d9683b93cd58b21c

The EBA recommendations are available at:

http://www.eba.europa.eu/documents/10180/449802/EBA-Rec-2013-04+Recommendations+on+asset+quality+reviews.pdf

EBA Consults on Draft Guidelines for Securitisations

On 17 December 2013, the EBA launched a consultation on draft Guidelines for originator institutions and national regulators for assessing significant risk transfer ("SRT") for securitisation transactions. The draft Guidelines include (i) requirements for originator institutions when engaging in securitisation transactions for SRT; (ii) requirements for national regulators to assess transactions that claim SRT; and (iii) requirements for national regulators when assessing whether commensurate credit risk has been transferred to third parties. The proposed Guidelines are required under the new CRR. Responses are due by 17 March 2014.

The consultation paper is available at:

http://www.eba.europa.eu/documents/10180/529039/EBA-CP-2013-45+%28CP+on+draft+Guidelines+on+SRT+for+securitised+assets%29.pdf

EBA Consultation on Guidelines on Discount Rate for Variable Remuneration

On 23 October 2013, the EBA published a consultation paper on draft guidelines setting out the calculation of the discount rate for variable remuneration. Under CRD IV, EU Member States have discretion to set a lower percentage than that required under the Directive, which requires that the variable component shall not exceed 100% of the fixed component of total remuneration. Responses to the consultation were due by 18 January 2014. The EBA must finalise the guidelines by 31 March 2014.

The consultation paper is available at:

http://www.eba.europa.eu/documents/10180/456620/EBA+CP+2013+40+%28CP+on+draft+Guidelines+on+the+discount+factor+for+variable+remuneration%29.pdf

Risk Dashboard of EU Banking Sector

The EBA published, on 29 October 2013, its first risk dashboard which summarises the main risks and vulnerabilities in the EU banking sector. The risk dashboard, which is based on Q2 2013 data, indicates that capital positions in banks have strengthened, that funding conditions have recovered although there is still a reliance on central bank funding and that asset quality is still a concern.

The risk dashboard is available at:

http://www.eba.europa.eu/documents/10180/15959/EBA+Risk+Dashboard+-+Q3+2013.pdf

EBA Recommends the Use of LEIs for Capital Requirements Reporting

The EBA published consultation proposals that recommend the use of legal entity identifiers ("LEIs") by financial institutions that are subject to the reporting obligations under the CRR. The use of LEIs for regulatory capital reporting purposes would, the EBA considers, enhance supervisory convergence and ensure high quality, reliability and comparability of data.

The consultation paper is available at:

http://www.eba.europa.eu/documents/10180/462920/EBA+CP+2013+42+%28CP+on+draft+Recommendation+on+the+use+of+LEI%29.pdf

EBA Publishes Reports on RWAs and Pro-Cyclicality

On 18 December 2013, the EBA published five reports relating to risk weighted assets ("RWAs") and pro-cyclicality. The reports are part of the EBA's work to address unjustified differences in the denominator of the capital ratios, to understand the sources of such differences and, if need be, to formulate the necessary policy solutions. The five reports are:

- Third interim report on the consistency of RWAs in SMEs and residential mortgages portfolios;
- Report on the comparability of supervisory rules and practices;
- Report on variability of RWAs for market risk portfolios;
- Report on the pro-cyclicality of capital requirements under the internal ratings based approach; and
- Summary report on the comparability and pro-cyclicality of capital requirements under the internal ratings based approach. This report was mandated by the European Commission.

The reports are available at:

http://www.eba.europa.eu/-/eba-publishes-reports-on-comparability-of-risk-weighted-assets-rwas-and-pro-cyclicality

EBA Results of Peer Review on Implementation of Guidelines on Stress Testing

On 12 November 2013, the EBA published a report setting out its findings following the review on implementation of the EBA Guidelines on stress testing. The review reveals that the Guidelines assessed have for the most part been implemented by national regulators, although there are some differences in the method and extent of implementation. The following conclusions emerge from the report:

- Dedicated stress testing technical experts should be involved;
- Stress test instructions at national level are currently spread over various supervisory manuals, identifying the need for centralised documents;
- National regulators often focus on the largest banks in their jurisdiction;
- The incorporation of stress testing into SREP and the joint decision process is handled differently across national regulators;
- Many regulators carry out substantial work on top-down stress testing, from both a micro-and macro-prudential perspective; and
- Very few regulators require reverse stress testing. If required, it is often as part of a recovery and resolution plan.
- Certain best practices were also identified in the report and the EBA recommends that the guidelines should be reviewed to incorporate those practices. Examples included (i) regulators should have standard procedures and manuals in place to assess stress testing frameworks during off- and on-site supervision; and (ii) where deficiencies or weaknesses are detected the follow-up processes should typically include regulators taking effective supervisory action.

The report is available at:

http://www.eba.europa.eu/documents/10180/482428/EBA+2013+Report+%28Report+on+the+Peer+Review+of+the+Stress+Testing+Guidelines%29.pdf

EBA Reports on EU Transparency Exercise

On 16 December 2013, the EBA published its report on the EU-wide transparency exercise. The disclosure exercise provides a detailed update on the composition of capital, RWAs by risk type, sovereign exposures (both direct and indirect) broken down by maturity and country, credit risk exposures (both defaulted and non-defaulted) and RWAs broken down by asset class and country of the counterparty and also loan to value per portfolio, value adjustments and provisions, market risk and securitisation exposures.

On 9 December 2013, the EBA published a follow-up review report on the compliance by EU banks with their Pillar 3 disclosure requirements. The report states that the areas of concern are scope of application, own-funds and disclosures related to credit exposures under the internal ratings based approach, securitisation, market risk and remuneration.

EBA Publishes XBRL Taxonomy for Reporting by National Regulators

On 2 December 2013, the EBA published the XBRL taxonomy that national regulators will use to remit data to the EBA as required under the CRR. The taxonomy defines a representation for data collection relating to own funds, financial information, losses resulting from lending collateralised by immovable property, large exposures and the leverage and liquidity ratios. The EBA states that many regulators will also use the taxonomy for the collection of data from banks and investment firms. The aim of the taxonomy is to assist regulators to identify and assess risks consistently across the EU and to compare EU banks in an effective manner. The final draft RTS on which the taxonomy is based is not yet in force. The EBA is expected to update the taxonomy early in 2014 to include additional reporting requirements on asset encumbrance, non-performing loans and forbearance.

The relevant documents and further information are available at:

http://www.eba.europa.eu/-/eba-publishes-xbrl-taxonomy-for-remittance-of-supervisory-reporting-by-competent-regulatory-authorities

EBA Guidelines for FX Lending to Unhedged Borrowers

On 20 December 2013, the EBA published final Guidelines on capital measures for FX lending to unhedged borrowers under SREP. The Guidelines specify the method to be used by national regulators when FX lending risk is deemed to be material and also when capital measures are deemed to be an appropriate method of treating this risk. The EBA acknowledges in the Guidelines that regulators may use supervisory measures under CRD IV to address this specific FX lending risk. The European Systemic Risk Board mandated the EBA to prepare the Guidelines in its Recommendation of 21 September 2011 on lending in foreign currencies. The final Guidelines are available at:

http://www.eba.europa.eu/documents/10180/535130/EBA-GL-2013-02+%28Guidelines+on+capital+measures+for+FX+lending%29.pdf

ESMA Publishes Revised Guidelines on Reporting under the AIFMD

ESMA published a revised version of its final Guidelines on reporting obligations under the Alternative Investment Fund Managers Directive ("AIFMD") on 15 November 2013. The Guidelines were initially published on 1 October 2013. The revised Guidelines provide clarification on the information that AIFMs should report to national competent authorities and the timing of such reporting together with the procedures to be followed when AIFMs move from one reporting obligation to another. The revised Guidelines have been published together with revised technical IT guidance and a revised reporting template. Once the revised Guidelines are published in the official EU languages on ESMA's website, national regulators have two months in which to notify ESMA of whether they comply or intend to comply with the revised Guidelines.

European Commission Adopts Regulation on Types of AIFM

On 17 December 2013, the European Commission adopted a delegated regulation which sets out the RTS for determining whether an AIFM is an AIFM of open-ended alternative investment fund(s) ("AIF") and/or closed-ended AIF(s). Under the AIFMD, AIFMs have to follow specific rules depending on whether or not they are AIFMs of open-ended and/or closed-AIFs. The Delegated Regulation will come into force 20 days after it is published in the European Official Journal and will be directly applicable across the EU.

The Delegated Regulation is available at:

http://ec.europa.eu/internal_market/investment/docs/alternative_investments/131217_delegated-regulation_en.pdf

EBA Guidelines on Retail Deposits

On 6 December 2013, the EBA published final Guidelines on retail deposits subject to different outflows for the purpose of liquidity reporting. The Guidelines propose that retail deposits subject to higher outflows should be allocated to one of three categories depending on the risk factors inherent in a specific deposit. The risk factors have been set in line with input from national regulators and taking into account feedback to the consultation on draft guidelines undertaken by the EBA in August 2013. Banks and investment firms will have to report the amounts of retail deposits allocated to each of the three categories together with their own estimates of expected outflows under stress conditions.

The final Guidelines on retail deposits are available at:

http://www.eba.europa.eu/documents/10180/515704/EBA-GL-2013-01+%28Retail+deposits%29.pdf

UK Developments

UK Banking Reform Act Finalised

The Financial Services (Banking Reform) Act 2013 (the "Banking Reform Act") was published on 19 December 2013. The Act implements the recommendations of the Independent Commission on Banking (known as the Vickers Report) on ring-fencing of retail banking from investment banking as well as the recommendations of the Parliamentary Commission on Banking Standards ("PCBS"). In addition to the ring-fencing measures, the Act covers measures on creditor bail-in, depositor preference, the regulation of payment systems, increased regulation of directors and senior employees, administration provisions for financial market infrastructure systems (other than CCPs), powers for the UK regulators to make rules applying to parent undertakings and claims management services. The UK Government published responses to its consultation on secondary legislation (undertaken in July 2013) on 18 December 2013. It is expected that draft secondary legislation will be put before Parliament soon.

Our client note on the ring-fencing provisions of the Banking Reform Act is available at:

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

PRA Publishes Policy Statement and Final Rules on RRPs

On 19 December 2013, the Prudential Regulation Authority ("PRA") published its policy statement and final rules on recovery and resolution plans ("RRPs") which will apply to banks and PRA-regulated investment firms. In addition, the PRA published separate supervisory approach statements on recovery planning and on resolution planning, setting out its approach and expectations of firms. The RRP framework came into force on 1 January 2014. The PRA notes that its supervisory approach statements will be amended and updated from time to time to reflect ongoing policy developments. The RRP framework may need to be amended in due course to ensure compliance with the BRRD.

The Policy Statement is available at:

http://www.bankofengland.co.uk/pra/Documents/publications/policy/2013/recoveryresolution8-13.pdf

PRA Clarifies Expectations on the Use of Malus

The PRA published a Supervisory Statement on 28 October 2013 which sets out how the regulator expects firms subject to the Remuneration Code to comply with the requirements on the use of malus. The Statement includes areas such as wording in policies and employment contracts, scope, procedures for considering malus cases and processes for calculating the amount of variable remuneration. The PRA also states that it intends to consult soon on extending the Remuneration Code to require firms to apply clawback to vested awards.

The PRA's Supervisory Statement is available at:

http://www.bankofengland.co.uk/pra/Documents/publications/policy/2013/appofmalusss2-13.pdf

Bank of England Proposes Stress Testing Framework for UK Banks

On 1 October 2013, the BoE published a discussion paper on the framework for stress testing the UK banking system. The discussion paper is the first step towards implementation of the Financial Policy Committee (the "FPC") recommendation in March 2013 that the BoE and the PRA develop proposals for regular stress testing of the UK banking system. The stress testing framework, to be conducted annually, would initially apply to the major UK banks and significant UK subsidiaries of foreign globally systemically important banks. The BoE is considering inclusion of the UK medium-sized banks as well as a separate concurrent stress-testing regime for CCPs. The aim of the stress testing framework is to provide a quantitative, forward-looking assessment of the capital adequacy of the UK banking system and individual institutions within it. The results are expected to (i) inform the FPC's assessment of the resilience of the financial system and so aid formulation of policy responses; and (ii) support the PRA Board decisions and actions on individual banks. Responses to the discussion paper were due by 10 January 2014.

The BoE's discussion paper is available at:

http://www.bankofengland.co.uk/financialstability/fsc/Documents/discussionpaper1013.pdf

HM Treasury Invites FPC to Review its Powers Regarding the Leverage Ratio

On 26 November 2013, the Chancellor of the Exchequer, George Osborne, wrote to the Governor of the BoE, Mark Carney, requesting the FPC to conduct a review into its powers for direction over the leverage ratio required by UK banks, either to set the minimum level or vary such level over time. The Chancellor encourages the FPC to start the review process early in 2014 once the current Basel implementation process is complete. The review is expected to include recommendations for the FPC to have powers to implement a leverage ratio ahead of the international timetable or to set a higher baseline ratio in some circumstances for UK banks as well as any provisions for the leverage ratio to be phased in.

PRA Publishes Final Rules Transposing CRD IV

On 19 December 2013, the PRA published its policy statement, feedback statement, final rules and supervisory statements on the implementation of CRD IV. The PRA's rules will apply to banks, building societies and PRA-regulated investment firms. The PRA notes that the implementation of CRD IV is the first time that the PRA is making rules in the new PRA Rulebook style which includes a new structure. The new PRA Rulebook will contain rules and directions. The supervisory statements, which will be updated to reflect ongoing policy development, will provide additional guidance where necessary.

The Policy Statement is available at:

http://www.bankofengland.co.uk/pra/Documents/publications/policy/2013/strengtheningcapitalps713.pdf

The PRA also published separate supervisory statements on the following areas of CRD IV, all of which are available at:

- The Internal Capital Adequacy Assessment Process and SREP;
- Stress testing, scenario analysis and capital planning;
- CRD IV and capital;
- The Basel I floor;
- Credit risk – securitisation;
- Credit risk – standardised approach;
- Credit risk – internal ratings based approaches;
- Counterparty credit risk;
- Market risk;
- Operational risk;
- Groups;
- Large exposures; and
- Credit risk mitigation.

The PRA rules on capital buffers will be made once secondary legislation is finalised designating the regulators appropriately for those rules, which legislation is expected in 2014. The remaining rules will come into force on 1 January 2014, subject to any transitional provisions. The PRA issued a separate Supervisory Statement on 29 November 2013 setting out its expectations for capital and leverage ratios for the eight major UK banks and building societies from 1 January 2014. The PRA expects the eight firms to meet the standards it sets in this statement in addition to those imposed by the PRA through the expected new rules implementing CRD IV.

The Supervisory Statements on the CRD IV topics above are available at:

http://www.bankofengland.co.uk/pra/Pages/publications/implemcrdiv.aspx

The separate Supervisory Statement is available at:

http://www.bankofengland.co.uk/pra/Documents/publications/policy/2013/capitalleveragess3-13.pdf

FCA Publishes Final Rules Transposing CRD IV

The FCA published, on 13 December 2013, its final policy statement and rules implementing CRD IV. The FCA rules will apply to FCA authorised investment firms, management companies and AIFMs. The FCA rules do not yet include provisions on capital buffers because the UK Government is expected, in Q1 2014, to issue legislation on capital buffers. The FCA will issue its final rules on capital buffers once it is able to take account of that legislation. The FCA rules will not apply to banks, building societies and investment firms supervised by the PRA.

PRA Supervisory Statement on Credit Risk Treatments under the CRR

On 30 December, the PRA published a Supervisory Statement on its approach to certain credit risk treatments under CRR which may apply to exposures to third country entities until 1 January 2015 where the PRA has approved such entities as eligible for such treatment prior to 1 January 2014 and the European Commission has not yet made an equivalence determination for the third country. The Supervisory Statement also includes a list of exchanges that the PRA considers to qualify as a recognised exchange under CRR, pending the adoption by the European Commission of technical standards specifying such exchanges.

A copy of the supervisory statement is available at:

http://www.bankofengland.co.uk/pra/Documents/publications/policy/2013/thirdcountry2013.pdf

UK Capital Requirements Regulations Published

On 16 December 2013, the Financial Services and Markets Capital Requirements Regulations 2013 were published. The Regulations implement CRD IV into UK law, including provisions on cooperation between the PRA and FCA, how the regulators should act as consolidating supervisors, disclosure and notification obligations of the regulators, the granting of permissions and the exercise of supervision by the PRA and FCA, particularly in regard to own funds, specific liquidity requirements, employee remuneration and diversity practices. The Regulations came into force on 1 January 2014 subject to any transitional measures.

The Regulations are available at:

http://www.legislation.gov.uk/uksi/2013/3115/pdfs/uksi_20133115_en.pdf

UK Legislation on Country-by-Country Reporting

The UK Government has issued the Financial Services and Markets Act 2000 Capital Requirements (Country-by-Country Reporting) Regulations 2013 which implement the country-by-country reporting requirements set out in CRD IV. CRD IV requires relevant firms to disclose annually: (i) their name, nature of activities and geographic location; (ii) number of employees; and (iii) their turnover, on a consolidated basis, by country where they have an establishment. The information must first be published, in part, by 1 July 2014. G-SIIs are additionally required to disclose to the European Commission on a confidential basis, by 1 July 2014, their pre-tax profit or loss, their taxes paid and any public subsidies received. The Commission will then assess the consequences of such disclosures, and subject to the outcome of that assessment, all firms subject to CRD IV may be required to make such disclosures from 1 January 2015. The Regulations came into force on 1 January 2014.

The Regulations are available at:

http://www.legislation.gov.uk/uksi/2013/3118/pdfs/uksi_20133118_en.pdf

The UK Government has also published Guidance on the application and interpretation of the Regulations, available at:

https://www.gov.uk/government/publications/capital-requirements-country-by-country-reporting-regulations-2013-guidance/capital-requirements-country-by-country-reporting-regulations-2013-guidance

UK Order on Qualifying EU Provisions

The UK Government published, on 10 December 2013, the Financial Services and Markets Act 2000 (Qualifying EU Provisions) (No. 2) Order 2013 which specifies certain directly applicable provisions of European Union legislation as "qualifying EU provisions" for certain provisions of the UK Financial Services and Markets Act 2000. The Order enables the FCA and the PRA to investigate and take enforcement action for any breach of the qualifying EU provisions. The current EU qualifying provisions are the CRR, any directly applicable regulations made under CRD IV and certain provisions of the CRA Regulation. The Order came into force on 1 January 2014.

The Order is available at:

http://www.legislation.gov.uk/uksi/2013/3116/pdfs/uksi_20133116_en.pdf

UK Regulators Respond to the Report of the Parliamentary Committee on Banking Standards

The BoE and the FCA published, on 7 October 2013, their responses to the June 2013 report of the PCBS. The PCBS report made a number of recommendations to the Bank, including the FPC and the PRA, and the FCA in four areas: individual responsibility, governance in banks, competition in banking markets and reinforced responsibilities of regulators. The regulators' response includes key steps to be taken in the near future, including (i) the PRA and the FCA will consult on a new regime to replace the approved persons regime in 2014 for implementation in 2015 (assuming the necessary legislative provisions are enacted through the Banking Reform Bill); (ii) the PRA will consult on a revised Remuneration Code in 2014; (iii) the PRA will consult on a requirement that a firm must operate in a way which is consistent with its safety and soundness; (iv) the PRA and the FCA will review the revised approach to authorising and regulating new banks; (v) the FCA will report on the diversity in the retail banking market within four years; and (vi) the FCA will consult on broadening access to the ombudsmen service in 2014.

The BoE response is available at:

http://www.bankofengland.co.uk/publications/Documents/news/2013/pcbsresponse.pdf

HM Treasury Review of the Balance of Competences in Financial Services

HM Treasury launched, on 21 October 2013, a call for evidence on the Review of the Balance of Competences – Single Market: financial services and the free movement of capital. The call for evidence is part of the wider review of the Balance of Competences between the UK and the EU. The review will examine the EU's competences in the field of financial services and consider whether the powers are appropriate and are being used appropriately, focusing on the competences and legislation that affects banks, insurance companies, pension companies, asset managers and market infrastructure providers, among others. Responses were due by 17 January 2014.

The call for evidence is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/251514/PU1568_BoC_FSFMC_CfE_proof4.pdf

FCA Confirms Policy on Publicising Warning Notices

On 15 October 2013, the FCA published a policy statement setting out the regulator's approach to publishing information about proposed enforcement action. The information will be published in a warning notice statement and will include the name of the firm, and, where appropriate, the name of the individual, as well as a brief summary of the facts that have led the FCA to issue a warning notice. The Financial Services Act 2012 conferred the power to publicize such information on the FCA. The FCA would not publish a warning notice statement if publication would be unfair to the person to whom the notice relates, prejudicial to the interests of consumers or detrimental to the stability of the UK financial system. The FCA began to apply its power to publish warning notice statements to warning notices published on or after 15 October 2013.

FCA Speech on Conduct Requirements for Foreign-owned Firms

On 13 November 2013, the FCA published a speech given by Clive Adamson, Director of Supervision at the Association of Foreign Banks in London. The speech sets out the FCA's approach to conduct regulation of foreign firms including on the assessment of a firm's culture, the accountability of senior management and the increased risks of financial crime.

UK Treasury Updates Transitional Arrangements for AIFMs

The UK Treasury published, on 19 December 2013, a statement which confirms that in 2014 it intends to amend the AIFM Regulations 2013 to provide that, if a transitional AIFM's application for authorisation or registration is submitted without sufficient time for the FCA to determine the application by 22 July 2014 (the end of the transitional year), that AIFM will be able to continue managing AIFs until the FCA has determined the application. The requirement to submit an application before 22 July 2014 will remain in place and all AIFMs will, in any event, be required to comply with all relevant AIFMD requirements from 22 July 2014, even if their application has not yet been determined.

The statement is available at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/268114/aifmd_transitional_arrangements_update_191213.pdf

FCA Publishes Guidance Note on Information Required on Depositary Arrangements for AIFMs

The FCA published, on 4 December 2013, a guidance note setting out the information it requires from prospective AIFMs about their depositary arrangements. The information is relevant to those firms applying for variation of their permission as well as new applicants. The regulator also clarifies that if any information is missing from a firm's application, then it cannot start to manage an alternative investment fund until a month after the information has been provided to the FCA, even if the FCA grants the firm authorisation during that period.

FCA Consults on Proposed Rule Changes for Recognised Investment Exchanges

The FCA published, on 18 November 2013, a consultation paper on proposed changes to its rules for recognised investment exchanges to take into account how the regulator will consider competition issues when supervising exchanges. The consultation paper clarifies that (i) competition considerations are among the relevant circumstances that the regulator will consider when determining if a recognised investment exchange satisfies the FCA's Recognition Requirements; (ii) an exchange's annual report should provide the regulator with information on events affecting competition; and (iii) proposed regulatory provisions which could affect competition in relevant product markets, by placing a material restriction or limitation (directly or indirectly) on third-party services providers, fall within the scope of the exchange's notification obligations. Responses to the consultation were due by 31 January 2014.

FCA Thematic Review of AML and Anti-Bribery Controls of Wealth and Asset Management Firms

In October 2013, the FCA published the findings of its thematic review into the anti-money laundering and anti-bribery and corruption systems and controls of 22 wealth and asset management firms. This follows similar reports published in respect of other industries.

The FCA found that there were some good examples of risk management at the firms that it reviewed, but that there were also a number of weaknesses in the firms' anti-bribery and corruption systems and controls. It concluded that that there is still work for most firms to do to ensure that bribery and corruption risks are appropriately mitigated. The FCA emphasised that given its previous communications in this area, it had expected firms to have taken more actions to reduce the risk of money laundering and bribery and corruption.

The FCA provided a number of examples of good and poor practice in Chapter 3 of its thematic review. For example, in relation to anti-bribery and corruption controls, examples of good practice include having gift and entertainment policies and procedures that clearly define the approval process including clear instructions for escalation, definitions and guidelines for staff to follow. Conversely, examples of poor practice include gift and entertainment activity which is not consistently monitored by senior management, or where the firm's policies and procedures do not address other areas of bribery and corruption but focus on only one area such as gifts and entertainment.

Following its review, the FCA expects all firms that it regulates to consider its findings and to improve their anti-money laundering and anti-bribery and corruption systems and controls where necessary. The FCA stated that its findings were of particular concern where the firms it reviewed were part of major financial groups which should have been aware of the FCA's expectations. The FCA also noted that significant weaknesses remained even at the firms it had visited which formed part of groups that had been subject to previous regulatory attention.

The FCA's thematic review is available at:

http://www.fca.org.uk/your-fca/documents/thematic-reviews/tr13-9

Contacts

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.

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