Quote of the Week

"The only change – and it will not come in any great rush – is that the UK will extricate itself from the EU’s extraordinary and opaque system of legislation: the vast and growing corpus of law enacted by ECJ from which there can be no appeal. This will bring not threats, but golden opportunities to pass laws and set taxes according to UK needs”

- Boris Johnson, MP (Vote Leave campaign)

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UK: Referendum Brexit vote; FCA mortgage pay shortfall; PEN BHS pension scheme; FCA new website launch; BoE PSR payments access; CSSF important shareholdings

Regulatory Watch List

Over-the-Hill UK Commissioner Hill resigns, replacement will hail from the less-renowned market center in Latvia. ECB to require Euro derivatives trading to take place within currency zone, as EBA sets to move to outside London.

Tip-top Regional trade deals including regulation between US and EU will face additional barriers to complete. More immediate focus on whether the UK will maintain all EU directives, or opt out of passport for specific sectors.

Stress-free Fed allows capital repayments, despite requiring resubmissions, plans higher buffers for largest firms. Foreign bank plans face objections, before expansion of tests are applied to newly-required US holding companies.
US Banking

FDIC Retention OLA Records
On June 24, FDIC issued rule for retention of records in the capacity as non-bank receiver.
• Title II gives FDIC power to effectuate orderly liquidation of non-bank, and access to records.
• Rule requires FDIC to retain schedules, as is necessary to maintain two categories of record.
• Records of the company that were in existence at the time the FDIC is appointed as a receiver.
• Also records generated by FDIC as receiver, and in exercise of its liquidation authorities.
• Records created less than 10 years before FDIC appointment are retained for six years.
• Those created by FDIC are maintained at least six years following termination of receivership.
• Records of covered financial company, if FDIC is receiver under Title II of Dodd-Frank Act.

Fed Stress Test Results
On June 23, Fed released supervisory stress test results for 33 bank holding companies (BHCs) for 2016.
• Fed said BHCs, with over 80 percent of banking assets, have more capital, better credit quality.
• Also, better able to lend to households and businesses in a severe recession than in 2015.
• Stress tests are challenging to evaluate year over year because Fed changed the scenario.
• Governor Tarullo said changes allow supervisors, investors, and the public to assess resiliency.
• "Key to sound stress testing regime, since the nature of future stress episodes uncertain."
• Aggregate CET1 capital would fall from 12 percent in 2015 to minimum 8.4 percent in stress scenario.
• Fed also released results from adverse scenario of moderate recession and mild deflation.
• In adverse scenario aggregate common equity capital ratio fell to minimum level of 10.5 percent.
• Fed also said will release annual CCAR results, on capital planning processes on June 29.

FDIC Small Business Lending
On June 28, FDIC launched survey of bank loan practices for small business customers.
• To study the general characteristics of small business borrowers, types of credit offered.
• Relative importance of commercial lending for banks of different sizes, business models.
• Also, look at data for banks based in urban and rural communities, which will inform on market areas for small business lending, and the perceived competition faced by banks.
• Ask on consumer transaction accounts to learn more on efforts to encourage the unbanked.
• Two thousand banks randomly selected to participate in web-survey, administered by Census Bureau.
• Will receive letter with direction on response, FDIC expects to report on results in late 2017.

FASB Credit Loss Accounting
On Jun 16, FASB issued accounting standard for Current Expected Credit Loss(CECL) by banks.
• Requires banks to record, at the time of origination, credit losses expected over life.
• On losses through the life asset portfolio on loan, and on held-to-maturity securities.
• Prior to CECL, losses were recorded, when it was probable that loss event has occurred.
• It is anticipated CECL will increase allowance for loan/leases losses across bank industry.
• CECL likely to mandate major operational changes at banks to process the standard.
• For collecting and analyzing data to support modeling of life-of-loan loss expectation.

Bank Regulators
On June 17, 2106, FDIC, Fed, NCUA and OCC issued joint statement on FASB standard.
• Applies to all-size banks, thrifts, credit unions, financial institution holding companies.
• For SEC registrant-banks, CECL will becomes effective in 2020, for all others in 2021.
• Agencies encourage institutions to begin planning implementation of the new standard.
• Bank staff should work closely with own executive and boards of directors in transition.
• Also, plan for impact of standard on the entity's capital in advance of the effective date.
• Regulators have described the new standard as biggest ever change in bank accounting.

FDIC External Credit Ratings
On June 22, FDIC issued proposed rulemaking on investment activities to remove credit ratings.
• Amends international banking regulations related to permissible investment activity.
• Applies to State-member banks operating foreign branches, US branch of foreign banks.
• Remove reference to external credit ratings and replace with creditworthiness standards.
• This change would also conform with Section 939A of Dodd-Frank Act on removing rating.
• Investment grade security would be one issued by an entity which has adequate capacity.
• Capacity to meet financial commitment for the projected life of the security or exposure.
• An entity has adequate capacity if default risk is low, and a timely repayment is expected.
• Proposed rule would require assets pledged to FDIC by insured branches of foreign banks.
• Pledged assets need to satisfy a liquidity standard, and be subject to fair value discount.
• Rule would add two asset categories eligible to be pledged: cash and GSE-issued obligations.
• On June 28, 2016, FDIC issued rule in the Federal Register, 60-day comment to August 29.
US Consumer

NYDFS 'Zombie' Properties
On June 23, NYDFS said Governor Cuomo signed laws on zombie properties, and to control foreclosures.
- Require mandatory settlement conferences by prescribing rights and duties of all the parties.
- Clarify how to protect homeowners contesting foreclosures, and help them from losing home.
- Consumer Bill of Rights informs owners of their right in foreclosure, discourages abandonment.
- Impose pre-foreclosure duty on banks, servicers to maintain vacant and abandoned properties.
- Places maintenance obligation on mortgagee when they knows or should know of vacancy.
- Imposes civil penalties up to $500 per violation, per property, for each day for failing to do so.
- Expedite foreclosure for bona fide vacant and abandoned properties homeowners do not want.
- Require foreclosing party to move to auction in 90 days of getting foreclosure judgment.
- Establish an electronic registry of vacant and abandoned properties to promote transparency

OCC High LTV Program Loans
On June 20, OCC requested comments on role of high LTV lending in revitalizing distressed areas.
- Current supervisory loan-to-value (SLTV) limits, requires LTV to be no higher than 90 percent.
- If over 90 percent, a loan needs credit enhancement, e.g., by mortgage insurance or liquid collateral.
- Limits are a hurdle in distressed areas for renovation finance to make homes habitable.
- Only owner-occupied residences in an eligible community allowed 100 percent+ LTV at origination.
- Non-credit enhanced first lien mortgage, is not permitted to exceed $200k principal amount.
- Banks should have specific board-approved policy/procedure for program loans to address.
- For defined geographies of eligible community and how will support revitalization effort.
- Limit aggregated level of committed program loans as a percent of Tier 1 capital, not above 10 percent.

DOE Predatory Student Loans
On June 16, DOE proposed rules to protect against predatory institutions, and allow loan forgiveness.
- Prohibits school use of mandatory pre-dispute arbitration clause and class action waivers.
- Which would seek to deny student day in court if they were wronged by education provider.
- Strengthens right for a student to have loan forgiven if defrauded or deceived by school.
- Creates trigger requiring school post funds if engage in misconduct, exhibit financial risk.

CFPB Mortgage Servicer Exam
On June 22, CFPB issued report on weak mortgage servicer processing, including failed technology.
- After the crisis, CFPB passed rules designed to eliminate surprise/runarounds for homeowners.
- Requires servicer to maintain accurate records, promptly credit payments, service borrowers.
- Rules also include protections for struggling homeowners, and those that face foreclosures.
- Compliance with rules need strong policy and procedures related to systems and technology.
- CFPB examiners found outdated and deficient technology poses risk for mortgage servicing.
- Lack training, testing, and auditing computer, software system, and of service providers.
- Loan modification information late, incorrect or deceptive, due to technology malfunction.
- Consumers get runaround, if loan transfers to a new servicer with incompatible computers.
- Also issued updated exam procedures on areas CFPB will be looking for in mortgage exams.
- Mortgage servicers should anticipate CFPB exam focus on complaint handling, requests.

House Senior Protection Bill
On June 16, House FSC passed seniors’ protection bill and Senate counterpart have bipartisan support.
- House said privacy laws make it difficult for financial firms to report potential fraud activity.
- Bill helps to protect institutions which identify, report and act to stop financial abuse of seniors.
- Provides banks, credit unions, IAs and broker dealers protection from civil or administrative liability.
- As long as employees of the firm are trained to spot and report risk senior predatory activities.
- Also, disclose possible exploitation of seniors when identified with reasonable degree of care.

State Model Law
- Senate co-sponsor Collins (R-ME) said reflects what Maine securities regulator does, as model law.
- Including use of training and other resources by NASAA, will train securities staff in 14 States.
- Bank group SIFMA also commended passage as will “tackle elder financial abuse head-on”.

Research Provision
- Provides resource and research on cognitive decline, as it is harder to detect than thought.
- As aging brain can be impacted by biological, psychological, environmental factors.
- Compromise healthy, apparently functioning person into making poor financial decisions.
US Securities and Investment Management

FINRA Complex Product Speech
On June 16, FINRA Executive Vice President Thomas Selman spoke at SIFMA on controls around complex products.

- Behavioral economists recognize that choice overload can impair rational decision-making.
- Includes products secured with collateral pool; with embedded derivative; or worst features.
- Where performance is tied to market index that is not well understood; and with contingency.
- Some products have multiple contingencies and analysis of this can be especially difficult.
- Per Notice 12-03, embedded options products require additional training and supervision.
- DoL fiduciary rule may limit complex product sales, where are not in best interests of client.
- Structured notes may shift risks from broker to retail clients, and may raise serious issues.
- Range accrual note may tie to performance of equity index causing forfeiture of principal.

FINRA Retirement Checklist
On June 17, FINRA issued retirement consideration alert for older workers.

- Issued major considerations for persons who are within a few years from their retirement.
- Pinpoint actual retirement age - may wait to 59 1/2 to avoid early withdrawal tax penalty.
- Others may delay to age 70, seek to maximize the Social Security deferred payment credit.
- Tool to estimate retirement income Social Security, at average age 62 women, 64 men.
- On June 20, 2016, FINRA published second part of investment alert on retirement planning.
- For Medicare info, on website; note Medicare usually does not cover long-term care.

SEC Mining Property Disclosure
On June 16, SEC proposed disclosure requirements for mining properties held by registered issuers.

- Align Regulation S-K Item 102 with industry, and global regulatory practices and standards.
- Reflects globalization, non-US adoption of standards is very different to industry guide 7.
- Require disclosures of resources, reserves, results in filed registration statements, reports.
- Rescind Industry Guide 7; include disclosure requirements, in a new part of Regulation S-K.
- Comment should be received in 60 days after publication of the rule in the Federal Register.

FINRA Investor Account Move
On Jun 21, FINRA issued investor alert on issues for account transfers after moves by their broker.

- Alert is focused on tips relating to possible account transfers when broker changes firms.
- Follows FINRA May 2016 Notice on Client Communication, effective on November 11, 2016.
- A number of firms have issued proprietary products that cannot transfer to other firms.
- Client should ensure they understand and are comfortable with new firm investment menu.
- Ask broker about conflicts of interest they may have as a result of his move to new firm.

SEC 'Flash Boys' IEX Exchange
On June 17, SEC approved IEX application to be registered as national securities exchange.

- IEX- Investors’ Exchange LLC became known via Michael Lewis’ book, Flash Boys, as way to offer institutional investors trading venue that would counter high-frequency trading.
- Ordered IEX to satisfy standardized conditions before it may begin transitioning its operation.
- Including via participating in national market system, join intermarket surveillance group.
- SEC DTM also issued guidance on treatment of automated quotations under Reg NMS.
- Intentional delays of under one millisecond are de minimis, and do not violate Rule 600(b)(3).
- On June 23, 2016, SEC issued interpretation in Federal Register, and is effective immediately.

SEC Risk Governance on Swaps
On June 16, SEC Deputy DTM Director Barnett spoke to ISDA risk governance standards for swaps.

- Urged participants to address risk management, culture and conduct, and board effectiveness.
- Crisis revealed limits of relying on managing risk via market discipline using self-interest.
- Company culture of compliance and risk can mitigate bad choices and other misconduct.
- Deposit banks and BDs have different business models that impact participation in derivatives.
- Banks finance long-term transactions via short-term assets, but access government-liquidity.
- But, BDs cannot rely on government resources, instead must fund through capital markets.
- Sees progress from stronger internal a udit, proactive compliance, compliance officer.
- Chief risk officers with appropriate seniority, independence and senior reporting lines.
International

**IOSCO, FSB Fund Data Gaps**

On June 22, IOSCO issued priorities on data gaps in asset management industry.

- Said gaps in collecting usable industry data, limits supervision, enforcement, monitoring.
- Seeks enhanced data on leverage, liquidity and use of derivatives to understand overall risks.
- Will use data to monitor asset diversification, assess liquidity positions of regulated funds.
- Data limited on separately managed accounts and global leverage and derivative exposures.
- Will continue consulting with industry and to support G-20 initiatives on hedge fund risk.

**FSB Vulnerabilities**

On June 21, FSB proposed to address structural vulnerabilities linked to asset management.

- For example, from liquidity mismatch between fund investments and shareholder redemption terms.
- Also, leverage within investment funds, securities lending activity of asset managers.
- Operational risk and challenges of transferring investment mandates in stressed conditions.
- Recommendation for liquidity mismatch focus on open-ended funds and ETFs, not MMFs.
- Those for leverage apply to all types of funds that utilize it, e.g., via borrowing or derivatives.

**Basel G-SIB Implementation**


- Report reviews the implementation of rules in China, EU, Japan, Switzerland and the US.
- Found implementation of G-SIB framework was positive, all five countries were compliant.
- China’s loss absorbency and disclosure were assessed as largely compliant and compliant.
- Aspects of China G-SIB framework noted as more conservative, including capital required.
- Found an issue in China and US, with use of non-euro-thresholds for disclosure reporting.

**Basel, IOSCO Cyber-Resilience of FMIs**

On June 29, Basel, IOSCO issued guide on cyber resilience for financial market infrastructures.

- Covers governance, identification, protection, response and recovery, and detection.
- Overarching components for FMIs are testing, situational awareness, learning and evolving.
- Urged FMIs coordinate and collaborate with other FMIs and stakeholders to help each other.
- Identify critical business functions, support information on assets to ensure protections.
- Also implement appropriate and effective controls design systems with security in mind.
- Expected to be able to resume their processes in two hours (also known as two-hour RTO, or 2hRTO).

**ASIC OTC Derivative Failings**

On June 20, ASIC issued report on failures in retail OTC derivative sector in treatment of customers.

- ASIC findings identify serious and widespread derivatives failings across a number of firms.
- Includes failing net tangible asset test and not notifying of change of controls.
- Misleading product descriptions, failures in financial reporting, and supervision of services.
- Found high degree of non-compliance above 70 percent of AFS licensees demonstrating issues.
- Eighty percent of firms demonstrated issues with product description disclosures, 50 percent failed to report.
- Sixty percent of firms underwent change of control, and 85 percent of those firms had failed to notify ASIC.
- Fifty percent required assessments to determine if they complied with asset requirements.

**CSRC Securities Risk Indicators**

On June 17, CSRC issued rules on securities sector risk control indicators.

- Change leverage ratio and other risk indicators to enhance capital and risk management.
- Improved net capital and risk capital reserve calculation formula for measurement quality.
- Net capital is divided into core and subsidiary, risk-adjusted assets into unified calculation.
- Leverage ratio at least eight percent of regulatory requirements to give more complete coverage.
- Single business risk indicator to distinguish between equity and non-derivative equity.
- Firms to include all subsidiaries in overall risk management system and better supervision.

**APRA Insurance Statistics**

On June 15, APRA proposed rules for reporting and publication of insurance statistics.

- Publication of general insurance statistics, based on non-confidential insurance data.
- Proposes statistics at industry- and institution-level, modernized segmentation and claims.
- Investment performance measures to be included in the quarterly insurance statistics.
- Includes investment income from trusts, held with shareholder funds and interest returns.
- Proposes additional capital adequacy statistics on insurance risk by class of business etc.
- Suggests including underwriting performance statistics in the industry-level quarterly data.
- General insurers to be segmented according to large group, mortgage insurer, and reinsurance.
- Direct insurers that are not LMI are to be segmented into personal and, commercial lines.
EU

**EIOPA Financial Stability Risks**

On June 21, EIOPA issued a report on stability risk in EU insurance and pensions.
- Observed monetary policy, and low crude oil prices, on protracted low yield environment.
- Environment likely continue in medium term, cannot rule out double-hit scenario.
- Growth in non-life insurance was higher than life insurers, picture mixed for life insurers.
- EIOPA 2015 stress test revealed occupational pensions vulnerable to persisting low yields.
- Especially likely to be true where low yield is matched with sharp increases in risk premium.
- Stress tests found national prudential regimes not fully sensitive to market price change.

**AMF AML Reporting to Tracfin**

On June 17, AMF issued a guideline on reporting AML suspicions to Tracfin.
- On obligation of firms to make AML reports under the AMF Tracfin reporting regime.
- Firms required to identify beneficial owner of business relationship before doing business.
- They should exercise constant vigilance and ensure knowledge of client is kept updated.
- Report to contain concise statement of suspicion, business and country of residence.
- Extends to disclosures of attempt to conceal information to avoid or partially avoid taxes.

**EU Council Bank Union Status**

On June 17, EU Council issued a roadmap status to complete banking union.
- Council will continue its technical work on EU Deposit Insurance Scheme (EDIS) to progress.
- Noted intent of EU States to start work in September 2016 on common backstop for resolution fund.
- Council to review bridge finance arrangements and need for common backstop.
- Backstop may become operational prior to the end of the transition period.
- States not yet all signed facility agreement to cover funding shortfall for resolved banks.
- Council proposes amending legal framework on total loss absorbing capital (TLAC).
- To ensure consistent rules and amounts for bailin-able buffers that contribute to a resolution.
- Proposes common approach to bank creditor hierarchy so legal certainty during resolution.
- Council to implement Basel reforms to impose leverage ratio, possibly three percent for systemic banks.

**ESMA Pre-Trade Market Waivers**

On June 20, ESMA issued an opinion on waiver from large pre-trade transparency.
- Opinion updates examples of functionalities that do not satisfy large in scale waiver.
- Applies to trading venues which operate order book based on MIFID reference price waiver.
- Also venues wishing to change algorithm to apply size-time priority logic.
- Orders with size below large in size threshold would be matched on basis of reference price.
- Reference price would be derived from another system which is using time priority basis.
- If order above size threshold, matched on reference price, using revised size-time priority.

**EP Deposit Insurance Scheme**

On June 17, EP issued a working document on EU deposit insurance scheme.
- Proposed reinsurance phase when scheme provides limited funding for liquidity shortfall.
- In reinsurance phase, EU Deposit Insurance Scheme (EDIS) would cover a share of losses.
- From 2020, EDIS will move to co-insurance phase, where EU States may request funding.
- Share borne by EDIS gradually rises from 20 percent to 80 percent in co-insurance phase until 2023.
- After four-year co-insurance, deposit guarantee schemes to become fully funded by EDIS.
- Notes EDIS needs Deposit Guarantee Schemes Directive be fully implemented as minimum.
- Also, Deposit Guarantee Scheme Directive allows numerous national options and discretions.
- TLAC, bail-in, insolvency harmonization and prudential rules, needed in parallel with EDIS.
- Implementation of banking union law (e.g., BRRD & DGSD) also necessary for EDIS.

**EU Corporate Tax Avoidance**

On June 17, EU Council agreed to a directive of anti-tax avoidance measures.
- Interest limitation rules seek to discourage the transfer of interest to low-tax jurisdictions.
- Impose limit on the amount of interest that the taxpayer is entitled to deduct in a tax year.
- Exit taxation rules, to stop tax base erosion when assets transferred to low-tax jurisdiction.
- General anti-abuse rule, to close off abusive tax arrangements not covered by specific rule.
- Controlled Foreign Company rule, re-attribute income low-taxed foreign subsidiary to parent.
- Hybrid mismatches rules lessen discrepancies, between results of national tax systems.
UK

Referendum Brexit Vote
On June 24, UK Government issued referendum result in favor of leaving EU by 53.7 percent majority.
- PM Cameron announced his resignation, to be effective in three months, new PM by October 2016.
- To remain as PM in meantime, to aid stability, but new PM to negotiate exit terms with EU.
- Process for UK to leave EU triggered by UK decision to invoke Article 50 of treaty on EU.
- Two years to agree exit terms, if no agreement, exit is automatic, unless all States agree delay.
- At which point, UK’s EU membership, access to free market and trade agreements will cease.
- FCA stated regulation derived from EU law remains applicable, firms must still comply.

BoE Statement
- BoE governor Carney spoke of an inevitable period of uncertainty, must expect volatility.
- BoE, Treasury are well prepared, extensive contingency planning to mitigate this risk.
- Core financial system is now well capitalized, liquid, strong, so banks can continue lending.
- Backed up by over £250B of BoE liquidity facilities, support orderly market functioning.
- G7 also issued statement, with steps to ensure liquidity, and to support market functioning.
- Fed said prepared to provide dollar liquidity, US Treasury secretary chaired FSOC meeting.

EU Response
- EU Council President Tusk issued statement, on referendum outcome, and consequences.
- Also statement with heads of EP Schulz, EC President Juncker, Dutch Presidency Rutte.
- Reassured EU is well prepared, remaining 27 states’ leaders are determined to stay unified.
- EU law, rights and obligations will continue to apply to UK until it formally leaves EU.
- EU Council meeting June 28-29, PM Cameron to attend, 27 leaders to discuss implications.
- On June 24, UK European Commissioner Hill resigned, replaced by Latvian Dombrovskis.

FCA Mortgage Pay Shortfall
On June 10, FCA proposed rules on mortgages with payment shortfalls, to be added to MCOB.
- MCOB 12.4.1BR sets out how firms expected to allocate payments received from customers.
- New rules designed to ensure firms do not impose unfair, excessive charges on customers.
- Payments from customers suffering shortfall to be allocated to minimize time to pay off arrears.
- Firms should not allocate payment to paying uncapitalized interest, charges due to shortfall.
- Amend definition of payment shortfall, clarify expectations, for appropriate protection levels.

PEN BHS Pension Scheme
On June 23, UK PEN began Pension Protection Fund assessment of BHS pension scheme.
- Follows BHS being placed in administration by its owner in April 2016.
- BHS was subsequently placed into liquidation by its administrators during June.
- Follows UK Parliament work and pensions committee inquiry on BHS’s sale, acquisition.
- Panel taking evidence as part of inquiries into Pension Protection Fund, pension regulation.

FCA New Website Launch
On June 13, 2016, FCA launched first phase of new website, video tour of features, and transcript.
- New sections live: homepage, About Us, firms, markets, consumers, and updated search tool.
- Aims to present information in clearer, more structured way, users to update existing links.
- Sector-specific hub pages, with news, events, publications, policy, pages for all firm types.
- Website is now complete except for news and publications sections, to follow in August 2016.

BoE PSR Payments Access
On June 17, BoE issued plans to widen access to real time gross settlement (RTGS) accounts.
- Follows BoE January 2016 plans for the redesign of UK settlement system, reports on progress.
- Extends direct access to non-bank payment service providers (PSP), e-money institutions.
- Aims to increase competition and innovation in the overall market for payments services.
- FCA and HMRC will develop a strengthened supervisory regime for RTGS account-holders.
- Legislative changes will also ensure that PSP’s access to RTGS systems is safe and efficient.
- PSR managing director Nixon welcomed BoE RTGS progress towards open access for PSPs.
- BoE will continue to engage, will consult in September-November 2016, publish blueprint early 2017

CSSF Important Shareholdings
On June 24, CSSF issued rules for reporting of large shareholding positions.
- Notification is required over threshold of 5 percent, 10 percent, 15 percent, 20 percent, 25 percent, 33.3 percent, 50 percent and 66.6 percent.
- Size of old shareholding not required to be disclosed when threshold of five percent is crossed.
- Publication due no later than last day of the month and must be updated if change occurs.
- Voting rights complete chain of controlled companies, starting with ultimate beneficiary.
- Instruments include unconditional rights or ability for the beneficiary but not the issuer.
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