FINANCIAL SERVICES REGULATION

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DLA PIPER

Introduction

Welcome

DLA Piper's Financial Services International Regulatory team welcomes you to the 44th edition of Exchange – International, our international newsletter designed to keep you informed of regulatory developments in the financial services sector.

This issue includes updates from the UK, the EU, as well as contributions from Ireland, Spain and the US, plus international developments.

In this edition, *In Focus* analyses the historical UK-EU Trade Agreement, which sets out the terms of future trade and cooperation between the UK and the EU following Brexit, and examines its impact on the financial services sector.

In the UK, we provide insights on the recent fines imposed by the Financial Conduct Authority on Barclays bank, on the one hand, and Charles Schwab, on the other, for failures to treat their customers fairly and for breach of safeguarding rules respectively. We also inform you about the Law Commission's call for evidence on the application of English law on smart contracts, among other topics.

With regards the EU, we provide an overview of the EU Commission's market-leading proposals for a regulation in markets for cryptoassets and for a pilot regime for market infrastructures based on distributed ledger technology. We also look at the new EU measures concerning non-performing loans, including relevant amendments to the Securitisation Regulation and Capital Requirement Regulation as well as the EU Commission's Non-Performing Loans action plan.

In Ireland the regulator is currently focusing on issues of individual accountability in the financial services sector and we provide practical insights on how firms should prepare to comply with the regulator's expectations regarding fitness and probity.

Climate change-related financial risks are now becoming part of the regulatory agenda in the US and we discuss the actions taken by the New York Department of Financial Services and other US regulators in this space.

Your feedback is important to us. If you have any comments or suggestions for future issues, we welcome your feedback.

The DLA Piper Financial Services Regulatory Team
January 2021.

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The FCA's extension of the deadlines for the Certification Regime and Conduct Rules

On 28 October 2020, the Financial Conduct Authority (FCA) published a policy statement titled 20/12: *Extending the implementation deadlines for the Certification Regime and Conduct Rules* (PS20/12). PS20/12 summarises the feedback received from its consultation on extending the implementation deadlines for the Senior Managers and Certification Regime (SMCR) and Conduct Rules as well as outlining its finalised rules for the extended guideline.

Overview of PS20/12

Following a request from the FCA, the Treasury has made a statutory instrument to delay the deadline for solo-regulated firms to undertake their first assessment of the fitness and propriety of their Certified staff from 9 December 2020 until 31 March 2021.

The FCA had also consulted to change the deadline for certification in the FCA Handbook to the same date and give corresponding extensions to the deadline for training staff on the Conduct Rules and reporting Directory Person data.

While the FCA encourages all firms to meet the original deadline of 9 December 2020 wherever possible, solo-regulated firms (except benchmark administrators) will have until 31 March 2021 to have fully implemented the SMCR, Conduct Rules and reported information on Directory Persons.

The FCA proposed to extend these deadlines to give firms significantly affected by the COVID-19 pandemic time to fully and properly implement the SMCR and to train staff effectively on the Conduct Rules. In doing so, the FCA has reiterated the importance of these noting that: "Our aim is to avoid firms having to choose between meeting their regulatory deadlines and realising their plans to achieve a full and effective implementation of the Senior Managers and Certification Regime and Conduct Rules. We want to support firms to make lasting changes to their governance, culture, conduct and capability."

Who do these changes apply to?

These changes affect all FCA solo-regulated firms authorised to provide financial services under the Financial Services and Markets Act 2000. Appointed Representatives are also in scope of the extension to the reporting deadline for Directory Persons. However, it should be noted that these changes do not apply to benchmark administrators.

Finalised rules

In summary, PS20/12 confirms that the deadline for the following requirements will be extended from 9 December 2020 to 31 March 2021:

- The date the Conduct Rules come into force, for staff who are not Senior Managers, Certification Staff or board directors;
- The date by which relevant employees must have received training on the Conduct Rules (this automatically follows from the extension in the previous bullet point); and
- The deadline for submission of information about Directory Persons to the Register references in our rules to the statutory deadline for assessing Certified Persons as fit and proper following agreement with the Treasury.

The FCA is also extending the implementation deadlines for Claims Management Companies (CMC) by an equivalent period. This means that a CMC receiving full authorisation on or after 9 December 2019 will have just over 15 months after the date of its full authorisation to meet the requirements mentioned above.

Extending the implementation deadlines

The FCA noted that while it recognises that uncertainty around COVID-19 may persist in the future, it has nevertheless stated that the extension until the 31 March 2021 should give all firms sufficient time to implement the SMCR and Conduct Rules. In this regard, no further extension will be made available.

Contractual discretion to close accounts – High Court quashes FOS determination

On 25 November 2020, the High Court handed down judgment in *TF Global Markets (UK) Ltd (t/a Thinkmarkets), R (On the Application Of) v Tan & Ors* [2020] EWHC 3178 (Admin), in which it held that the Financial Ombudsman Service (FOS) had applied the wrong test when deciding that an online brokerage company had not been entitled to close the accounts of certain clients for suspected market misconduct. On an objective reading of the terms of trading, the court held that the company had a contractual discretion to close the accounts in question. The FOS decision was quashed and the complaints have been remitted to the FOS for determination on whether the firm exercised its contractual discretion reasonably.

Unilateral account closure decisions can often trigger complaints which escalate into disputes, even when the firm has followed all the necessary policies and procedures. This case focuses on the interpretation of contractual terms designed to provide the firm with the discretion to close accounts when it suspects wrongdoing. Firms are often disinclined to challenge a decision of the FOS through judicial review. It may be a comfort to see that it was a challenge worth making in this case.

Background

TF Global Markets (UK) Ltd (TF Global) operated an online platform for dealing in investments, including forex trading and derivatives. Each of the complainants had been engaged in forex trading on the platform. TF Global suspected that the complainants had taken advantage of price latency or had been engaged in market manipulation because: their accounts exhibited evidence of arbitrage trading; and, in some instances, collusion to take advantage of price latency. Relying on its contractual terms of trading, TF Global purported to close the accounts and also withheld sums, on the basis of the above suspicions.

The complainants complained to the FOS, who determined that: (i) the relevant terms only permitted TF Global to act as it had if the market manipulation had actually taken place; and (ii) that it was for the FOS to determine, on the balance of probabilities whether it had in fact taken place. The FOS determined it was "no more than a possibility" that the complainants had conducted abusive trading.

TF Global challenged the FOS determination via judicial review; seeking an order quashing the final decisions.

Points of interest from the judgment

- The task before the court, in a case such as this, is to determine the objective meaning of the language used in the contractual terms of trading.
- It was clear from a reading of the contract as a whole (the FOS had focused very much on one clause) and the regular use of discretionary words throughout the contract, such as: "which we judge," "in our absolute discretion" or "acting in our reasonable sole discretion"; that this contract was drafted to give TF Global contractual discretion to close the accounts. It was, therefore, for TF Global to determine whether there had been a trade which it judged to be indicative of misconduct.
- Such contractual discretion is subject to a duty not to exercise that discretion arbitrarily, capriciously or unreasonably (often referred to as the "Braganza duty," after the 2015 Supreme Court case of the same name).
- It was not for the court, in this case, to determine whether that discretion had been reasonably exercised.

Practical implications

The FOS decisions have been quashed and the matter will now be remitted to the FOS, who will need to consider whether that discretion was exercised reasonably as against each complainant. In making this determination, the court highlighted that the FOS will need to give detailed consideration to the evidence available to TF Global at the time of making the decision to close the accounts and withhold the profits of each individual.

This provides a further reminder of the importance of recording, in writing, the rationale behind account closure decisions.

Committee of Advertising Practice publishes guidance on the advertising of delayed payment services

On 2 December 2020, the Committee of Advertising Practice (CAP) published its Guidance on the advertising of delayed payment services which includes unregulated credit such as Buy Now Pay Later. The guidance is relevant to the delayed payment providers, as well as the merchants incorporating delayed payment services into their online checkout. Advertisers are expected to swiftly align their practices to comply with this new guidance and have until 2 March 2021 to do so. After this date, matters of non-compliance will be dealt with in a formal manner.

The guidance aims to prevent marketing communications for delayed payment services from misleading customers. The overarching principle is that, before deciding to use the delayed payment service, customers should have sufficient information to understand what the service is (ie credit), the significant conditions or unusual terms, how they should settle their balance and what penalties or fees they may be subject to.

The guidance is relevant to all forms of marketing communications for delayed payment services and in brief requires these types of communications to:

- Be clear that delayed payments are a form of credit;
- Explain the credit checks that may be undertaken by the provider and the consequences on customers credit scores;
- Not imply that the delayed payment service is suitable for all customers or that it is risk-free credit;
- Ensure that *free* claims are qualified if there are associated fees such as late payment fees; and
- State the nature of the contract offered, any limitation, expense, penalty or charge and withdrawal terms, unless the advert is brief or general in scope and this information is freely available before using the service (ie by including a link to full terms).

Where a delayed payment service is presented at an online checkout, all the payment options should be clear to customers and obvious that standard forms of payment are available, as well as the delayed payment option and access should be given to the full terms and conditions of the service, including consequences for late or missed payments. A link to these can be used provided that it is in the section of the checkout process that offers the delayed payment service. Significant conditions or qualifications, including fees, penalties, and payment schedules should be made clear as part of the checkout process and not just through a link to terms.

UK consumer finance legislative reform – the pressure is mounting

The pressure to reform the out of date legislative landscape for consumer credit in the UK intensifies. Since the Financial Conduct Authority's (FCA) review of the retained provisions of the Consumer Credit Act 1974 (CCA) in 2019 there has been no substantive change and so the pressure for reform from the consumer finance industry and its trade associations continues to gather momentum. On 8 December 2020, the Finance & Leasing Association and other trade bodies including the Consumer Credit Trade Association, the Association of Alternative Business Finance and the British Vehicle Rental & Leasing Association sent a briefing paper called *Consumer Credit Act – the case for reform* to the Economic Secretary to the Treasury, John Glen MP calling for reform of the CCA.

The paper notes that the current legal and regulatory regime for consumer credit "is complex, out-of-date, inflexible and hard to navigate" referring to 27 statutory instruments made under the CCA, various consumer protection laws, FCA rules, the Payment Services Regulations 2017 and the FSMA legislation.

The suggestion for a more simple FCA Rules and Financial Services and Markets Act (FSMA) based approach after the UK ceases to be bound by the Consumer Credit Directive next month has been put forward with the aim to create a modern CCA regime, to better serve the evolving demands of the modern consumer and the businesses operating in this market.

The trade bodies have offered to host roundtable discussions where industry and consumer representatives could devise a comprehensive strategy for CCA reform with HM Treasury and the FCA.

The paper provides examples of various inadequacies with the current regime and proposes improvements which include:

- Simplification of the consumer credit legislative landscape via a twin-track approach of the Financial Services and Markets Act 2000 and FCA rules;
- Streamlining unsympathetic forbearance measures, to give borrowers the help and information they need promptly and in a transparent manner;
- Modernising the prescriptive requirements for giving consumers arrears and default notices;
- Simplifying the pre-contractual information that is required to be given to consumers before entering into an agreement, so this can more easily be provided through digital channels;
- Developing a more agile approach to cater for the evolution in consumers' use of credit and hire products, aligning hire and credit documentation requirements and the levelling up of consumer hire protections with those provided for credit; and
- Re-balancing of the sanctions faced by creditors for non-compliance with certain CCA provisions so that these are more proportionate to the harm that has been caused to the borrower.

FCA fines Barclays: Failure to show forbearance and due consideration to customers who experienced financial difficulties

On 15 December 2020, it was announced that Barclays has been fined GBP26 million by the Financial Conduct Authority (FCA) for "failing to show forbearance and due consideration to business and retail customers when they fell into arrears or experienced financial difficulties." The fine is levied in addition to a remediation exercise conducted by the bank, which has resulted in payments to customers totalling GBP273 million.

The fine relates to breaches that took place between April 2014 and December 2018. In particular, the FCA found evidence that some retail and small business customers who had been offered consumer credit during this period were treated poorly when they fell into arrears.

Summary of breaches

More specifically, Barclays was found in breach of the following rules, according to the Final Notice:

- PRIN 6 (treating customers fairly): failure to engage and re-engage appropriately with customers; failure to have appropriate affordability conversations; and failure to identify indicators of financial difficulty or vulnerability.
- PRIN 3 (systems and control) plus CONC 7.2.1R (policies and procedures for accounts that fall into arrears): inadequate resourcing; inadequate training; insufficient focus on customer outcomes in MI and QA testing framework; unreliable and unsuitable IT systems; inadequate policies for identifying customers who were vulnerable or were experiencing financial difficulties; and oversight and governance systems failed to identify poor customer outcomes and take necessary remedial action.

These failures, in addition to other "errors" (for example, charging fees during a breathing space hold) resulted in Barclays offering customers forbearance solutions that were unaffordable or unsustainable.

The products affected by the breaches were: retail current accounts; personal loans; business accounts; motor finance and unsecured loans for consumer goods (Barclays Partner Finance); credit cards; and charge cards.

We note that three specific consumer case studies have been included in the Annex (including two examples where life events or working arrangements caused irregular income). This is usually fiercely resisted by firms on the basis that it is not representative to pull out example cases. These cases are also referred to in the body of the notice.

The penalty

No figure for disgorgement was taken into account because it was considered that the bank's significant remediation exercise negated any direct financial benefit it may have received. In particular, 1.53 million accounts remediated with payments to customers totalling GBP273 million.

Barclays' track record was an aggravating factor (seven fines since the 2008 crash, albeit none in the past five years), but it was given credit for cooperation and remediation (which is rather rare). On balance, the mitigating factors outweighed the aggravating factors and a 10% reduction was applied.

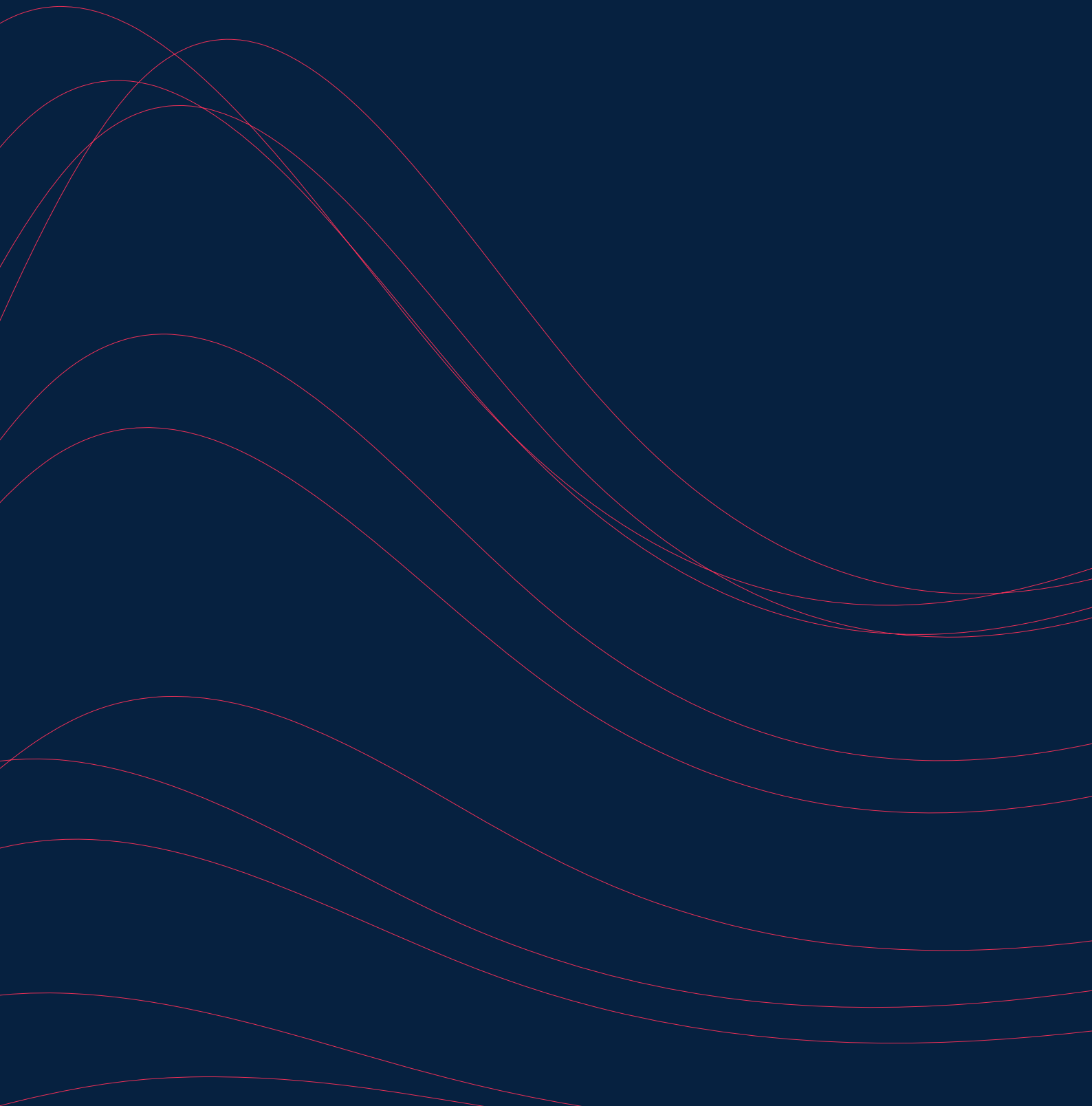
Commentary

The FCA restated its expectation that consumer credit firms should take adequate measures to properly understand their customers' financial difficulties. The FCA requires firms to show forbearance and due consideration to customers in arrears or who experience financial difficulties, to avoid a situation where a customer, under financial pressures, ends up making payments on a consumer credit loan at the expense of a priority debt, such as a mortgage, council tax, child support payments or utility bills.

Also, firms must ensure staff who work in collections and recoveries receive appropriate training and effective management information, to allow firms to monitor customer outcomes and take appropriate action where needed.

Unfair treatment of vulnerable customers and those who fall into financial difficulty will be a particular focus for the FCA in light of the COVID-19 pandemic.

Firms would be well advised to review the failings highlighted in the Final Notice and conduct a thorough gap analysis as against their own systems and controls. It is important to remember that when considering whether to open an investigation, take enforcement action and when calculating penalties, the FCA takes into account recent statements (including those contained in final notices) that relate to similar breaches.



Law Commission launches call for evidence on smart contracts

On 17 December 2020, the Law Commission published a call for evidence on smart contracts. The Law Commission intends to produce a scoping study in autumn 2021, based on the feedback received, explaining how the current legal framework applies to smart contracts and identifying areas where legal reform may be needed.

The call for evidence follows the publication by the UK Jurisdiction Taskforce of a Legal Statement on cryptoassets and smart contracts in November 2019.

According to the Law Commission "there is a compelling case for reviewing the current legal framework in England and Wales to ensure that it facilitates the use of smart contracts," in order for it to remain a competitive choice for business.

In particular, the Law Commission's work is focused on "smart legal contracts," which are legally binding contracts in which some or all of the terms are recorded in or performed by a computer program deployed on a distributed ledger.

The call for evidence seeks stakeholders' views about the ways in which smart contracts are being used in practice and the extent to which the existing law can accommodate their use. Interested parties may provide their feedback by 31 March 2021.

MORE SPECIFICALLY, THE CALL FOR EVIDENCE EXPLORES THE FOLLOWING TOPICS:

- What is a smart contract?
- Formation of smart contracts
- Interpretation of smart contracts
- Remedies and smart contracts
- Consumers and smart contracts
- Jurisdiction

The call for evidence looks at interesting issues, such as whether a smart contract can satisfy an "in writing" requirement, whether it can be "signed" or whether it can be used to create a legally binding deed.

The Law Commission sets out their own understanding of how the current law applies to each issue, without making any proposals for reform of the law at this stage.

FCA fines Charles Schwab UK GBP8.96m over safeguarding and compliance failures

On 21 December 2021, the Financial Conduct Authority announced that it has imposed a GBP8.96 million fine on Charles Schwab UK Ltd, a UK investment firm, for "failing to adequately protect client assets, carrying out a regulated activity without permission and making a false statement to the FCA."

Summary

The CASS (PRIN 10) related breaches occurred after the firm changed its business model to enable it to provide passported services to EU clients without the need for separate approval in each country. Client money was swept across from the firm to its affiliate based in the US. The client assets, which were subject to UK rules, were then held in the US affiliate's general pool, which contained both firm and client money and which was held for both UK and non-UK clients.

In addition, the FCA found that the firm did not at all times have permission to safeguard and administer custody assets, and failed to notify the FCA of the breach when it applied for the correct permission.

In response to a request for information, the firm told the FCA that its auditors had confirmed that the firm had adequate systems and controls in place to manage client money and client asset transactions. Several individuals were responsible for reviewing and drafting the reply to the FCA. They assumed that there was a written record of the auditor's confirmation and corresponded about locating it. However, they failed to make appropriate enquiries and therefore did not realise that no such record existed. Consequently, the firm provided a false response.

The firm took remedial action at various points after discovering the breaches. There was no actual loss of client assets and the firm stopped holding client assets from 1 January 2020.

Commentary

The case illustrates the FCA's continuing focus on strict CASS compliance; a focus that will have been redoubled by a combination of the current economic climate and recent high-profile reports of the FCA's failure to supervise investment firms which subsequently failed.

Mark Steward, Director of Enforcement, has an interest in outcomes that punish conduct that creates a "risk of harm"; this is seen as part of the process of slowly re-orientating the culture of the financial services sector. This is another case demonstrating that fines will not be escaped simply because misconduct did not result in actual harm. Indeed, "risk of loss to customers" was taken into consideration at step 2 of the penalty calculation, which determines the percentage multiplier to be applied to reflect the seriousness of the breach. In this case the breach was assessed to be level 4 (the most serious is level 5).

Step 3 of the penalty calculation considers mitigating and aggravating factors. For the portion of the calculation attributed to the CASS breaches, four mitigating factors are identified alongside only one aggravating. The aggravating factor is the FCA's prolific publication of the importance of adequate protection for clients' money and custody assets and the extent to which it has drawn firms' attention to the need for increased focus on this area. The significance of this aggravating factor is reflected in a 10% uplift in the portion of the penalty attributed to the CASS failings.

EU

European Commission adopts legislative proposals for regulations for markets in cryptoassets and pilot regime for market infrastructures based on DLT

In September 2020 the European Commission (the Commission) adopted a legislative proposal for Regulations for markets in cryptoassets (known as MiCA) and on a pilot regime for market infrastructures based on distributed ledger technology (the Regulations). The proposed Regulations are part of a broader digital finance package introduced by the Commission to enable and support the potential of digital finance to boost innovation and competition, while at the same time mitigating risks stemming from it.

As part of the Commission's March 2018 FinTech Action plan, the European Supervisory Authorities were mandated to produce advice on the applicability and suitability of the existing EU financial services regulatory framework on cryptoassets.

This proposal takes into consideration advice received from the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA).

For both cryptoassets and distributed ledger technology (DLT) market infrastructures the Regulations have four overarching objectives:

- **To create legal certainty** – a robust legal framework that clearly defines the regulatory treatment of all cryptoassets not covered by current legislation is required.
- **To support innovation** – a safe and proportionate framework that supports innovation and fair competition is needed to promote the development of cryptoassets and use of DLT.
- **To ensure appropriate levels of consumer and investor protection and market integrity** – as most cryptoassets are unregulated, this is of particular importance.
- **To ensure financial stability** – some cryptoassets have the potential to become widely accepted and embedded in the financial system. Consequently, safeguards are required to address risks to financial stability and policy that could arise from these cryptoassets.

Next steps and timing

The proposed Regulations will be considered by the Council of the EU and the European Parliament.

Once adopted, it is proposed that MiCA would apply in EU Member States 18 months after entry into force, apart from provisions in respect of asset-referenced tokens and e-money tokens, which would apply from the date the regulation enters into force.

It is proposed that the Regulation on a pilot regime for market infrastructures based on DLT would enter into force 20 days after publication in the OJEU and apply 12 months after that.

Cryptoassets: what is the commission proposing and why?

Some cryptoassets already fall under existing EU financial services regulations and will remain subject to the relevant legislation. For example, some qualify as financial instruments and are subject to EU securities markets legislation such as MiFiD.

But where existing rules are not suitable for cryptoassets and distributed ledger technology, the Commission is proposing a pilot regime for markets that trade and settle in financial instruments in cryptoasset form.

This pilot regime allows for exemptions from existing rules, and allows regulators to gain experience on the use of DLT in markets and for companies to test out DLT-based solutions. The intention is to allow companies to learn more about how the current rules operate in practice, and see whether changes are needed to allow innovation.

For cryptoassets that are not covered by any existing legislation, the Commission is proposing a framework designed to protect consumers and the integrity of previously unregulated cryptoasset markets.

The proposed regulation will cover entities issuing cryptoassets, firms providing services around cryptoassets, entities that allow customers to buy or sell cryptoassets for fiat currency or other cryptoassets, cryptoasset trading platforms, and many others.

It also contains requirements for stablecoins, cryptoassets designed to minimise the volatility of their price by tying their value to a stable fiat currency or other stable asset. Stablecoins are further divided into e-money tokens and asset-referenced tokens. Stablecoins that are more systemic, or "significant," will be subject to enhanced rules.

Cryptoassets: which assets and services will be regulated under the new regime?

The Regulation will cover all cryptoassets not currently caught under existing financial services regulations.

THE REGULATION LISTS THEM AS FOLLOWS:

- **Utility Tokens** – a type of cryptoasset that is intended to provide digital access to a good or service, available on DLT, and is only accepted by the issuer of that token.
- **Asset-Referenced Tokens** – a type of cryptoasset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several cryptoassets, or a combination of such assets.
- **E-Money Tokens** – a type of cryptoasset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender. They will be treated and regulated as e-money under the Electronic Money Directive 2009.

Cryptoassets: key elements of the proposal

In-scope cryptoassets can be admitted to trading on specialist platforms or offered to the public. On the whole, issuers will have to be authorised, unless the market (including eligible investor class, as qualified investors only) is limited.

To be authorised, there will be a requirement for cryptoasset service providers to have a physical presence in the EU and they will be subject to prior authorisation from a national competent authority before commencing their activities. The compliance standards they will need to meet are capital requirements, governance standards, an obligation to segregate their clients' assets from their own assets, and cybersecurity requirements

There will be a prohibition on market abuse in the secondary markets for previously unregulated cryptoassets. Measures will be implemented to prevent insider dealing and market manipulation. For example, cryptoasset service providers would be required to have surveillance and enforcement mechanisms to deter potential market abuse.

Cryptoasset issuers will be required to publish a white paper including all the relevant information on the specific cryptoasset. The information would include a detailed description of the issuer, the project and planned use of funds, conditions, rights, obligations and risks. In addition, members of the issuers' management body will have to meet probity standards, and there is a proposed prohibition on misleading market communications by issuers.

Issuers of asset-referenced tokens will have to be authorised, meet governance requirements, comply with conflict of interests rules, possess disclosure stabilisation mechanisms, comply with investment rules and meet additional white paper requirements.

Issuers of e-money tokens will need to be authorised and comply with regulatory requirements of the Electronic Money Directive and the Regulation on Markets in Cryptoassets.

Cryptoasset service providers will need to comply with prudential requirements, rules on safekeeping clients' funds, governance requirements, complaint handling procedures, and management of conflicts of interest. There are additional type-specific requirements dependent on the type of cryptoasset service provider.

For effective supervision, Member States have to choose a competent authority as a single point of contact. The EBA is the supervisor of issuers of significant asset-referenced tokens. Significant e-money token issuers are dual supervised by the EBA and national competent authorities.

Cryptoassets: scope of the new regime

There are transitional provisions in the Regulation that include a grandfather clause for cryptoassets issued before the entry into force of the Regulation, with the exception of asset-referenced and e-money tokens.

For example, several wallet providers already possess financial licences (such as licences as electronic money providers) and several cryptoasset service providers are already regulated institutions for anti-money laundering purposes.

But, as has been mentioned already, previously unregulated cryptoasset service providers and issuers will be caught by this Regulation.

Cryptoassets: stablecoins

Asset-referenced tokens and e-money tokens are the new terms used for stablecoins. For both categories, minimum rights for investors are proposed. An example being the claim that a token holder would have against the issuer of a stablecoin.

E-money tokens will have to comply with rules set out in this new regime as well as those in the Electronic Money Directive. Issuers of e-money tokens would have to offer a 1:1 redemption right for their tokens.

Minimum requirements for asset-referenced tokens include: holders having the right to withdraw directly from the issuer in case of significant variation in value, liquidity arrangements between the issuer and asset-service providers buying and selling these tokens, and a wind-down plan that contains contractual arrangements ensuring token holders are paid any potential proceeds.

DLT market infrastructures: main features of the pilot regime

The Regulation aims to allow the operation of a DLT market infrastructure by establishing clear and uniform requirements. The overarching aim is to remove regulatory hurdles to issuance, trading and post-trading of financial instruments in cryptoasset form, and to allow business to test and regulators to gain experience on the use of DLT market infrastructures.

The regime sets out the requirements for getting permission to operate a DLT market infrastructure, details the limitations on the transferable securities that can be admitted to trading, and outlines how the DLT market infrastructure, competent authorities and ESMA all work together.

In parallel, as part of this legislative package, it is proposed to amend the second Markets in Financial Instruments Directive (MiFID II) to make clear that financial instruments can be issued on a DLT and to exempt DLT market infrastructures temporarily from requirements to allow solutions for the trading and settlement of transactions of cryptoassets to be developed.

It should be noted that permissions to operate are never permanent, but are temporary and will be regularly reviewed by supervisors. Market operators who then fail to meet the relevant criteria can no longer run the pilot.

ESMA will carry out a review of the pilot regime five years after it comes into force.

Impact of Brexit: UK regime

It is important to note that the Regulations will not come into force until after the UK's departure from the EU. The UK will not have to comply with any of the proposed legislation. However, even with that being the case, a couple of things bear mentioning.

There already exists some regulation of cryptoassets in the UK. Regulated tokens are security tokens (defined as tokens amounting to a "Specified Investment" under the Regulated Activities Order, excluding e-money) and e-money tokens (defined as tokens that meet the definition of e-money under the Electronic Money Regulations). The creation of the UK Cryptoasset Taskforce in 2018, as well as the cryptoasset consultation paper and policy statement the FCA issued in 2019 and HM Treasury's 2020 consultation on cryptoasset promotions indicate UK regulatory appetite to introduce measures to ensure consumers are protected, market integrity is upheld and that competition works in the interest of consumers. The recent FCA ban on the sale of derivatives and exchange traded notes referencing certain types of cryptoassets to retail consumers is framed from the perspective of preventing consumer risk. Further regulatory consultation is also anticipated.

The rapid growth of the digital token market, and access to international markets will be relevant factors for the UK and UK-based business. The EU proposals do have some parallels and equivalents in the UK financial services regulatory framework. The FCA compliance requirements for governance (SYSC), client money (CASS rules), complaints handling (DISP handbook), and capital adequacy (General Prudential handbook) are part of the compliance landscape for some of the products that firms offer in this space.

While the UK is clearly focused on having a robust regulatory environment for cryptoassets, there is some perceived rigidity in the EU proposals. In particular there is non-dynamic categorisation of digital assets and strong alignment with existing definitions. For example, the division of stablecoin into separate regulatory brackets, one under the highly European e-money categorisation, is not necessarily resonant with a fully global approach. Through consultation and reflection, from a UK perspective, on its comparative existing regulatory platform and strong global interactivity, we would advocate a more dynamic regulatory environment being maintained.

EU Commission Work Programme 2021: Key takeaways

On 19 October 2020, the European Commission published its Work Programme for 2021, which sets out the Commission's priorities for the coming year. The Commission also published the accompanying Annexes to the Work Programme, which provide a detailed list of initiatives the Commission is planning to deliver upon in the year ahead.

Background – main themes

Against the backdrop of the COVID-19 pandemic, the Commission's focus in 2021 will be twofold:

- Firstly, managing the COVID-19 health crisis and starting to draw the lessons from it. In particular, the Commission will continue its efforts to find, finance and secure a safe and accessible vaccine.
- Secondly, implementing the NextGenerationEU plan to recover from the crisis and build a better future. This plan will focus on sustainable investment and reforms, with 37% of expenditure of the Recovery and Resilience Facility dedicated for green transition spending, while a minimum of 20% will be invested in the digital sector. In addition, the Commission will ensure that 30% of NextGenerationEU's EUR750 billion will be raised through green bonds.

THE WORK PROGRAMME SETS OUT SIX HEADLINE AMBITIONS:

1. The European Green Deal
2. A Europe fit for the digital age
3. An economy that works for people
4. A stronger Europe in the world
5. Promoting the European way of life
6. A new push for European democracy

Financial services – main initiatives

With regard to the financial services sector in particular, the Commission intends to focus on a number of initiatives, including promoting the investment protection and facilitation framework, which aims to optimise the investment climate in Europe and encourage cross-border investing. The Commission will also continue its work for the revision of the Solvency II Directive as well as the second Markets in Financial Instruments Directive (MiFID II) and Regulation (MiFIR). It will also focus on the Anti-Money Laundering (AML) legislative package.

Other initiatives aiming to ensure that Europe is fit for the digital age include a proposal for a Regulation on digital operational resilience for the financial sector (DORA). In addition, the Commission will focus on the proposal for a Regulation on Markets in Crypto-assets (MiCA), which aims to set out a comprehensive pan-EU framework for cryptoassets, together with its accompanying proposal for a regulation on a pilot regime for market infrastructures based on distributed ledger technology, which seeks to facilitate trading and settlement of digital securities.

As per next steps, the Commission will start discussions with the Parliament and Council to decide on a list of joint priorities on which co-legislators agree to take swift action.

European Commission review of the Consumer Credit Directive

On 5 November 2020, the European Commission published several documents which report on the findings of the Commission's work to evaluate the effectiveness of the Consumer Credit Directive (CCD). These documents include:

- A report to the European Parliament and the Council which identifies areas where the CCD has had a positive impact as well as its shortcomings;
- A Commission's evaluation report; and
- A standalone executive summary of the evaluation exercise.

The European Commission launched a consultation to evaluate the CCD in January 2019. The aim of the evaluation exercise was to examine whether the CCD objectives had been achieved and whether the CCD remained fit for purpose. It also considered the impact on consumer protection across the EU and whether it had any influence on the pan-European consumer credit market.

Main findings

As a result of the evaluation, the Commission has identified the following:

- The CCD has broadly achieved the objectives of ensuring high standards of consumer protection and the development of a well-functioning internal EU credit market.
- The cross-border credit market is limited and hampered by low levels of harmonisation of the regulatory framework; however, the digitalisation of credit and consumer interest in this, may help with developing a stronger cross-border credit market.
- The CCD provides a framework to protect consumers which some Member States have chosen to "gold-late" through their national legislation.
- Some of the more effective provisions in the CCD relate to withdrawal rights, early repayment and the Annual Percentage rate of Charge (APR).
- There are differing approaches and a lack of standardisation relating to affordability/ creditworthiness assessments and the types of information used in these assessments. Access to information about consumers across EU Member States is limited.
- Market developments, changing consumer habits, new types of credit product, digitalisation and technological innovation all need to be considered and CCD provisions should be adapted to ensure that the CCD remains effective in providing appropriate consumer protection.
- The CCD is generally effective, easy to understand and complements other relevant EU consumer legislation, greater clarity and consistency in its application would benefit consumers and creditors as well as a greater degree of consistency with the Mortgage Credit Directive and GDPR.

The findings should help inform appropriate revisions to the CCD which are planned for the second quarter of 2021. Future EU consumer credit rules are unlikely to directly affect the UK market after EU exit day. However, as UK regulators continue to liaise with the EU, some of the approaches taken under the CCD could be adopted in the UK to provide some degree of consistency between the EU and UK policy and regulatory frameworks.

CJEU case on PSD2 interpretation: C-287/19 DenizBank AG v Verein für Konsumenteninformation

On 11 November 2020, the First Chamber of the Court of Justice of the EU (CJEU) published a preliminary ruling in the case of *Denizbank AG v Verein fur Konsumenteninformation* (Case C-287/19) on the interpretation of the revised second payment services directive (PSD2).

The case concerns the interpretation of PSD2; in particular, focussing on the use of tacit consent of variation, the transfer of liability for unauthorised payments to the payment service user and the application of PSD2 to near-field communication (NFC or contactless) functionality.

Validity of tacit consent to contract variation

The CJEU was asked whether Article 52(6)(a) of PSD2, read in conjunction with Article 54(1), must be interpreted to mean that a payment service provider (PSP) may unilaterally vary the terms of their framework contract with any given user of services by virtue of the presumption of tacit (or passive) consent as per the conditions set out in the change provisions of the framework contract, even in circumstances where the user is a "consumer."

In a welcome decision for PSPs, the CJEU did not follow the Advocate General's April 2020 opinion that tacit acceptance of changes to terms and conditions in framework contracts could only be relied on in respect of "non-essential changes." Instead, the CJEU found that PSD2 does not restrict the type of terms that can be changed by tacit consent, but where the payment service user is a consumer, the Unfair Terms in Consumer Contracts Directive applies.

Legal separability of NFC (contactless) functionality

In addressing whether the contactless functionality of a personalised multifunctional bank card constitutes a "payment instrument," the CJEU considered the legal separability of such NFC function.

The CJEU found that contactless functionality is legally separable from other functions of a bank card and therefore, taken in isolation, it constitutes a payment instrument within the meaning of Article 4(14) of PSD2.

As such, the CJEU ruled that a payment card may incorporate several separate payment instruments which may hold knock-on effects with regards to how payment cards and their respective credentials are issued by a PSP and, in turn, what may be deemed an unsolicited payment instrument.

Defining 'anonymous' use

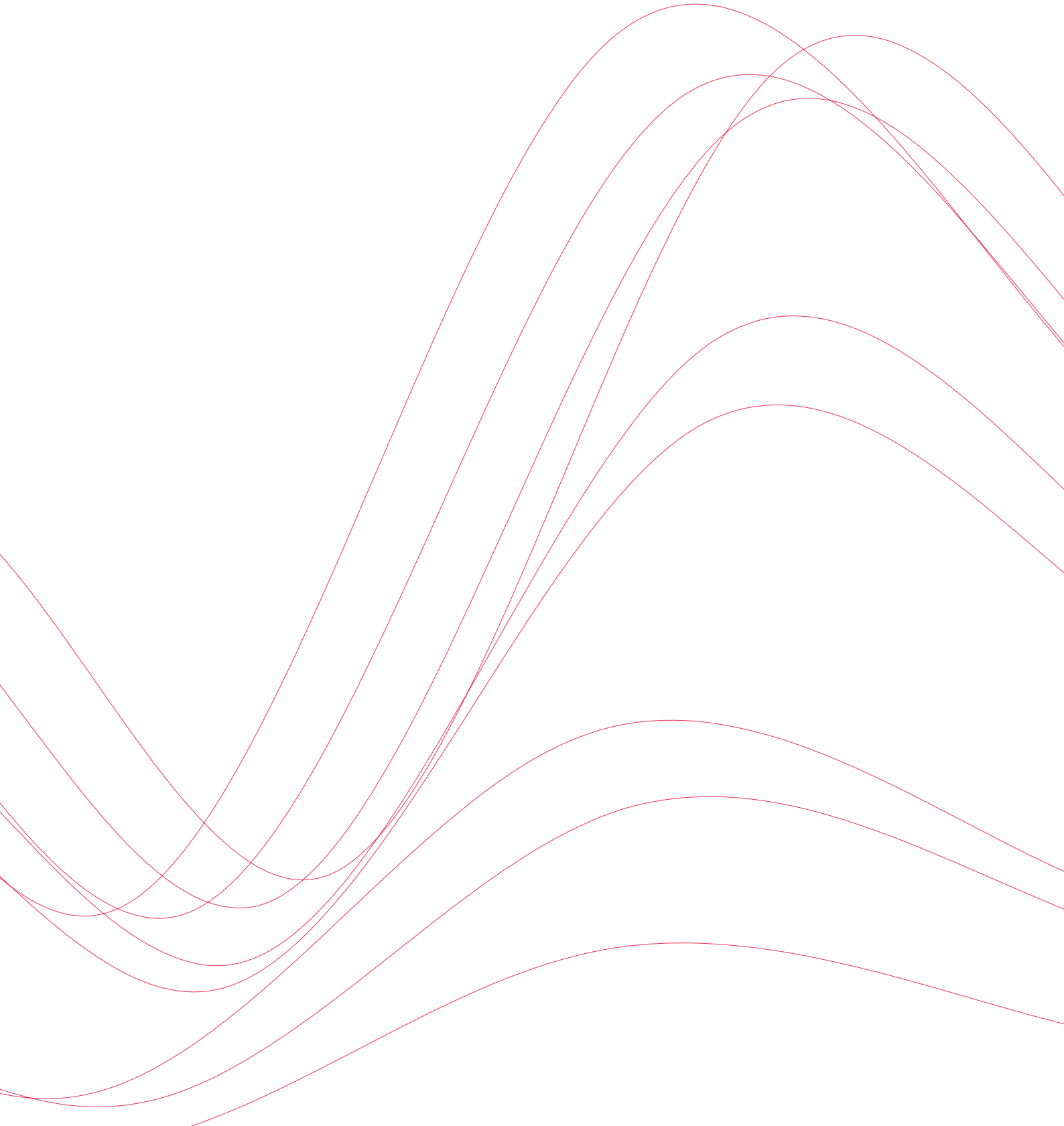
The CJEU was also asked to consider whether contactless functionality of a personalised multifunctional bank card would constitute "anonymous" use of the payment instrument in question. The CJEU ruled that the use of NFC functionality for low-value payments constitutes "anonymous use" within the meaning of Article 63(1)(b) PSD2.

Article 63(1)(b) allows parties to derogate from various protective provisions under PSD2 such as: (i) Article 72, which requires the PSP to prove the authentication and execution of payment transactions; (ii) Article 73, which establishes the principle that the PSP is liable for unauthorised payment transactions; and (iii) Article 74(1) and (3), which allows partial derogation of liability for unauthorised payments onto the payer up to an amount equalling EUR50, except after notification to the PSP of the loss, theft or misappropriation of the payment instrument.

Such derogations permitted under Article 63(1)(b) in respect of low-value payment instruments may only occur in circumstances where "the payment instrument is used anonymously" or where "the payment service provider is not in a position for other reasons which are intrinsic to the payment instrument to prove that a payment transaction was authorised." The CJEU concluded that a PSP shall be "objectively unable to identify the person who paid using that functionality and thus unable to verify, or even prove, that the transaction was duly authorised by the account holder."

Burden of proof required for further Article 63 derogations

A PSP cannot, without evidence, rely on the derogation under Article 63(1)(a) to relieve itself from its obligation to protect users of payments services against loss caused by fraud. The CJEU ruled that the burden of proof sits with the PSP to establish that the instrument does not allow its blocking or prevention of its further use.



Brexit: EBA statement on information for EU customers of UK financial institutions

On 8 December 2020, the European Banking Authority (EBA) published a statement providing guidance on how UK financial institutions should treat their EU customers after the end of the Brexit transition period.

The Brexit transition period expired on 31 December 2020. The EU and the UK reached a trade agreement on 24 December 2020, which is discussed in the In Focus section of this publication. Importantly, passporting rights have now ceased for UK financial institutions, which means that they must have put in place appropriate arrangements to continue servicing EU customers or cease their EU operations.

Specifically, UK firms may only provide financial services to EU customers through EU-authorised entities going forward. In cases where the authorisation process has not been finalised before 31 December 2020, UK institutions servicing EU customers are expected to have in place contingency plans setting out alternative measures until they receive their authorisations.

With regards to cross-border payments between the EU and UK, the EBA reminded EU payment service providers that they will be required to provide more information about the payer for cross-border payments and direct debits from the EU to the UK, compared to intra-EU transfers. More specifically, they will also need to include details on the payer's name and either the payer's address, official personal document number, customer identification number or the date/place of birth. This means that EU customers wishing to transfer funds between the EU and UK may be asked by their payment service providers to provide these further details.

EU customers with existing bank accounts in the UK may continue to maintain these, in accordance with the relevant UK legal requirements. This means that the UK deposit protection rules will apply to such bank accounts. If, however, the bank account is maintained with an EU-based branch of a UK financial institution, it will no longer be covered by the UK deposit guarantee scheme. EU customers are therefore urged to contact their bank or local regulator to find out how their rights might be affected.

UK institutions are expected to have already reached out to their EU customers and informed them about the availability of their services after 31 December 2020. If they plan to cease their operations, then they must inform their customers of the impact of the discontinuation of services and explain to them how they can exercise their rights.

Non-performing loans – new EU measures

Amendments to the securitisation regulation and capital requirement regulations

On 9 December 2020 the negotiators from the Economic and Monetary Affairs Committee and the European Council reached agreement on amendments to the Capital Requirements Regulation and the Securitisation Regulation (the Regulations). On 15 December, the European Council issued the final compromise text to the Permanent Representatives Committee. The formal adoption of the final texts is targeted for February 2021.

The amendments to the Regulations put forward by the European Commission on 24 July 2020, in response to the need to put measures in place to assist economic recovery following the COVID-19 crisis, included amendments to:

- extend the STS regime for balance sheet synthetic securitisations, which would allow banks to transfer certain risks to the market, thus allowing the bank to benefit from a prudential treatment reflecting the real risk of these instruments; and
- remove the regulatory impediments to allow for the securitisation of non-performing loans (NPLs).

The aim of the amendments is to allow banks to improve their regulatory capital position and enable them to lend to small and medium-sized enterprises and households.

The European Commission's NPL action plan

On 16 December 2020 the European Commission presented a strategy (the Strategy) to prevent a future build-up of NPLs across the EU. The Strategy builds on measures previously implemented in the context of Economic and Financial Affairs Council's NPL action plan of 2017.

THE STRATEGY HAS FOUR MAIN GOALS:

1. To further develop secondary markets for distressed assets, which will allow banks to move NPLs off their balance sheets, while ensuring further strengthened protection for debtors. This will be undertaken by, inter alia:
    - swift agreement of its proposed Directive to allow banks to move NPLs off their balance sheet and to ensure debtor protection in the secondary market;
    - amendments to the Securitisation Regulation (discussed above) allowing NPL securitisations;
    - establishing a data hub at a European level which would act as a data repository accessible by the key participants in the NPL market;
    - addressing regulatory impediments to NPL sales by banks. The European Commission acknowledged that, together with the European Banking Authority, it will implement a suitable approach to the regulatory treatment of purchased defaulted assets and the risk weights that banks need to apply to calculate the capital requirements under the Standardised Approach for credit risk. Currently a purchaser of an NPL needs to apply a higher risk weight to the NPL than the seller was required to apply. The European Commission believes that addressing this issue would benefit smaller banks purchasing NPLs and increase buy-side competition; and
    - developing guidance for sellers of NPLs on a "best execution" sales process.
2. To reform the EU's corporate insolvency and debt recovery legislation, which will help converge the various insolvency frameworks across the EU, while maintaining high standards of consumer protection. This will be achieved by, inter alia:
    - agreement between the European Parliament and Council on their proposal for a Directive for minimum harmonisation rules on accelerated extrajudicial collateral enforcement (which agreement the European Commission has urged). This will allow for legal certainty and recovery by both creditor and debtor;
    - the transposition of Directive EU 2019/1023 on preventive restructuring frameworks, which requires action to be taken before entities go into default; and

- continued work by the European Commission (as announced in the 2020 Capital Markets Union Plan) on harmonisation of insolvency law regarding the opening of insolvency proceeds, ranking of claims, avoidance actions, tracing of assets in an insolvency estate and asset valuation.

3. To support the establishment and cooperation of national asset management companies (AMCs) at EU level. Measures include, inter alia:
   - allowing impaired commercial real estate and large corporate exposures to be moved to an AMC. The European Commission acknowledges that a number of factors would make it difficult to set up a single European AMC. These factors include the diversity of NPLs and the different national rules on restructuring, insolvency and collateral enforcement;
   - permitting national AMCs to exchange practices and experiences at an EU level which would increase transparency and improve efficiencies at a national level; and
   - support from the European Commission to interested Member States in setting up national AMCs through the existing AMC Blueprint (which explains how an AMC can be set up, conditions for asset transfer and the effective operation of an AMC).
4. To implement precautionary public support measures, where needed, to ensure the continued funding of the real economy under the EU's Bank Recovery and Resolution Directive (BRRD) and State Aid frameworks.

The European Commission acknowledges that Member States through various policies have indirectly protected banks from potential credit losses. It reiterates that market-based solutions should be used in tackling NPLs, but does provide that measures under BRRD and the State Aid framework are available to solvent banks.

The proposed amendments to the Securitisation Regulation to deal with NPLs and the European Commission's Strategy have been long awaited by the market, which is expected to see a rise in NPLs in 2021. While the amendments set out in the Securitisation Regulation will apply to the 27 Member States (expected to be in H1 2021), we await both national and European measures to give effect to the Strategy, and it is unlikely we will see any real developments on this in H1 of 2021.

US

New York Department of Financial Services calls on financial institutions to consider climate change risk

On 29 October 2020, the New York State Department of Financial Services (NYDFS) published a letter to the state's banks and regulated non-depository institutions explaining what NYDFS sees as the principal financial risks stemming from climate change.

The letter calls on financial institutions regulated by the state to work to incorporate climate-related financial risks into their governance, strategy, and risk management. The NYDFS letter highlights both the physical and the transitional risks of climate change facing financial institutions. These risks range from the increased threat of inclement weather to physical assets (both the institution's proprietary assets and assets securing outstanding loans) and supply chains, to the potential for fossil-fuel assets to become "stranded" in the transition to a renewable energy economy.

To address these risks, the letter urges financial institutions to implement specific business practices and governance reforms. For instance, NYDFS suggests that banks designate a board member or committee, as well as a senior management function, to be accountable for assessing and managing climate-related risks. Similarly, NYDFS expects regulated non-depositories to assess how the direct and indirect risks of climate change could affect their balance sheets and to identify steps to mitigate those risks.

Because financial institutions are affected by climate change in different ways and have varying levels of resources, NYDFS advises that "each organization should take a proportionate approach that reflects its exposure to the financial risks from climate change and the nature, scale, and complexity of its business."

While the letter makes no specific mention of penalties or other enforcement tools, New York state-regulated institutions should be prepared for NYDFS examiners to inquire as to the institution's actions and approaches in connection with climate change risk.

New York's voice in a growing choir

While the NYDFS letter primarily focuses on the identification and mitigation of risks to financial institutions regulated by New York state, it is part of a groundswell of efforts at state level to address climate-related risk. In 2018, another New York regulator, the New York Attorney General (NYAG), brought a civil securities fraud case against Exxon Mobil under the state's Martin Act and alleged the company had made material misstatements concerning how it accounted for the costs of climate change regulation. Although Exxon Mobil prevailed at trial in the NYAG litigation, the Massachusetts Attorney General last year filed a similar lawsuit, which is still pending, alleging that Exxon failed to disclose climate-related risks to its investors.

On the legislative front, recently Illinois passed the Illinois Sustainable Investing Act (ISIA) requiring every Illinois "public agency" and "governmental unit" to incorporate ESG and "sustainability factors" into their investment decisions, particularly when doing so is profitable, minimises risk, and comports with their fiduciary duties. That law, in turn, joins the efforts of state pension funds like CalPERS in California and the New York State Common Retirement Fund, which have voluntarily adopted rules requiring consideration of ESG factors in their investment decisions. Other states and municipalities are also taking or considering similar steps.

In addition, for the first time, the Federal Reserve Board (Fed) has officially identified climate change as a potential threat to the stability of the financial system and said it is working to better understand the danger. In its semi-annual Financial Stability Report, published on 9 November 2020, the Fed includes a discussion of the implications of climate change in the section titled "Near-Term Risks to the Financial System." The report does not include any new mandates, policy directives or official guidance because the Fed is in the early stages of analysing the issue. It does identify several approaches to "moderate climate-related financial vulnerabilities or the likelihood of large shocks," including more transparency from financial firms on how

their investments could be affected by frequent and severe weather and could improve the pricing of climate risks, "thereby reducing the probability of sudden changes in asset prices."

Randal Quarles told the Senate Banking Committee at a November 10 hearing that he expects the Fed to be accepted for membership early next year in the Network for Greening the Financial System, a global coalition of central banks and regulators seeking to ensure that the financial system is prepared to deal with risks posed by climate change.

Next steps for financial institutions

Financial institutions operating under the NYDFS's oversight may wish to consider the following steps for incorporating climate-related risks into their governance, strategy, and risk management.

- Identify business operations subject to increased climate change risks.
- Review company accounting policies to determine whether climate change risks are properly accounted for.
- Create a board committee to review loans, assets, and commercial agreements for climate change risks.
- Include climate change risk analysis in the institution's corporate governance and oversight policies.
- Consider climate change related issues in presenting potential investments and loans to clients and external partners.

Conclusion

Climate change risk analysis can help inform a financial institution's business practices and help it better analyse vulnerabilities in asset and lending portfolios. In turn, this can help financial institutions meet regulators' growing expectations that these institutions take greater responsibility for their exposure to climate change risks. With its recent letter, the NYDFS is taking explicit steps to communicate those expectations to the market.

OCC proposes rule to prevent banks from blocking loans to certain industries

The Office of the Comptroller of the Currency (OCC) has proposed a rule that would stop banks from denying loans and other services to particular industries, such as fossil fuels, private prisons, firearms retailers and money services businesses.

OCC's notice of proposed rulemaking, announced on 20 November 2020, would codify more than a decade of guidance from the agency that banks should provide access to services, capital and credit based on the risk assessment of individual customers, rather than broad-based decisions affecting whole categories or classes of customers.

Bank practices which would be prohibited by the rulemaking have allegedly existed since "Operation Choke Point" – initiated in 2013 by the Obama Administration's Department of Justice to target and "choke off" financial access for certain disfavoured industries – gave rise to informal and unwritten recommendations by regulators to banks they supervise. Certain customers have experienced difficulty establishing and maintaining bank relationships when banks purportedly make sweeping decisions to distance themselves from industries, and banks are often circumspect in their basis for refusal of service – making it difficult for these businesses to respond or address concerns.

The OCC said the proposal would apply to the largest banks in the country that may exert significant pricing power or influence over sectors of the national economy. "Fair access to financial services, credit, and capital are essential to our economy," said Acting Comptroller of the Currency Brian P. Brooks. "This proposed rule would ensure that banks meet their responsibility to provide their services fairly since they enjoy special privilege and powers because if the system fails to provide fairness to all, it cannot be a source of strength for any."

Ireland

Fitness and Probity back in the spotlight: Time to start preparing for the Individual Accountability regime?

On the 17 November 2020, the Central Bank of Ireland (CBI) published a "Dear CEO" letter to Regulated Financial Service Providers (RFSPs). This letter was published following a thematic inspection by the CBI of a sample of firms in the insurance and banking sectors. The purpose of the inspection was to assess the level of compliance with Fitness and Probity (F&P) requirements and follows on from a similar CBI letter in 2019. The 2019 letter highlighted certain failures on the part of RFSPs, including a failure to (a) provide for the ongoing nature of their obligations under the F&P regime, (b) report issues regarding F&P to the Central Bank, and (c) carry out sufficient due diligence before appointing or nominating individuals to senior positions.

The 2020 inspections found a wide divergence of standards in the implementation of the F&P Regime, as well as issues relating to the role of the Board, the conduct of due diligence, the outsourcing of CF roles, engagement with the CBI and the role of the compliance function.

The 2020 letter emphasised the objectives of the F&P regime that "regulated firms and individuals who work in these firms are committed to high standards of competence, integrity and honesty, and are held to account when they fall below these standards." The CBI expressed its concern that RFSPs failed to carry out formal "gap analysis" of their F&P polices, processes and procedures following the 2019 letter.

We believe the increased focus by the CBI on the F&P regime relates to the future introduction of the Individual Accountability Framework (IAF), which will apply to individuals working in the financial services sector, as well as an increased pressure to hold individuals in the financial services industry to account generally in Ireland and across other jurisdictions (see below in relation to FCA developments in this area).

Competence, integrity and honesty

The 2020 letter reminds firms that a failure to comply with F&P obligations can result in sanctions under its Administrative Sanctions Procedure (ASP) or a prohibition order to prevent individuals from performing controlled function roles in any RFSP. Since the commencement of the Fitness and Probity Regime the CBI has issued eight prohibition notices relating to, inter alia, misconduct and fraud.

At the beginning of November, the UK Financial Conduct Authority (FCA) announced that it had banned three individuals from working in the financial services industry for non-financial misconduct. In 2018, all three men were (separately) convicted of various criminal offences. The nature and severity of the offences varied but all involved serious offences against the person. The FCA has imposed the bans on the basis that the men are not fit and proper as they lacked the necessary integrity and reputation required to work in the regulated financial services sector.

This is not the first example of the FCA publicly stating its view that non-financial misconduct contributes to poor culture and outcomes within the sector; but it is the first time that we have seen it take enforcement action. Irish RFSPs should be mindful that the CBI may well follow suit in taking action against individuals for non-financial misconduct.

Actions to take

Looking at the experience in the UK, there are practical steps employers in the financial services sector can start to take to prepare for the new IAF regime. RFSPs can use this opportunity to address the issues identified by the CBI and in carrying out their risk gap analysis use the opportunity to start early preparations for the introduction of the IAF in Ireland.

The 2020 letter clearly sets out the CBI position that it is "wholly unacceptable that such shortcomings continue to exist in circumstances where the F&P Regime was introduced 10 years ago." The expectation being that all RFSPs will "take appropriate action to address the significant issues identified in the Dear CEO Letter" and that firms should be able to evidence this to the CBI, if requested.

Spain

The CNMV approves new rules on advertising of investment products and services

On 13 November 2020, Circular 2/2020 of 28 October of the Spanish Securities Market Commission, on advertising of investment products and services (the Circular) was published in the Spanish Official Gazette.

The Circular concerns the regulation of advertising of investment services and products and includes various criteria that the Spanish Securities Market Commission (CNMV) has already been applying in its supervisory practices, in particular in light of the recent increase in advertising activities related to complex financial products.

This Circular will come into force on 13 February 2021, except for the requirement relating to the internal advertising records, described below, which will come into force six months after the publication by the Bank of Spain of the technical specifications that the records must meet.

The Circular applies to the advertising of financial instruments and structured deposits, investment services and activities, fund management activities (of UCITS and AIFs), the activity of securitization funds management, crowdfunding and crowdlending services, and any other financial products or services subject to the supervision of the CNMV.

The Circular is applicable not only to Spanish and foreign financial institutions with an establishment in Spain (ie investment firms, credit institutions providing investment services, management companies (UCITS managers and AIFMs), crowdfunding and crowdlending platforms, etc.), but also to foreign financial institutions operating in Spain under the freedom to provide services without a branch. However, foreign financial institutions operating in Spain on a cross-border basis will not be required to have the commercial communication policy and the internal records mentioned below.

The Circular specifies what is meant by advertising activity. Specifically, it is defined as any form of advertising promotion, regardless of the media and advertising formats used for its dissemination. For the first time, the Circular introduces a specific regime for advertising in audiovisual, radio or digital media and social networks.

The Circular also details the procedures and internal controls required for the entities to be able to carry out advertising activities. In particular, entities carrying out advertising activities relating to investment products and services must have a commercial communication policy that must be approved by the relevant management body. Entities must also keep internal records, duly updated and at the disposal of the CNMV for five years, of all advertising campaigns identified by correlative order number and commercial name and including the minimum documentation contained in the Circular.

International

FSB report says COVID-19-induced March market turmoil demonstrates need to address systemic risk of non-banks

The Financial Stability Board (FSB) is vowing to address concerns underscored by the market turmoil, economic shock and related liquidity stress that erupted in March 2020 as the COVID-19 pandemic crashed the global economy. On 17 November 2020, the FSB published a letter from its chair and two reports delivered to G20 Leaders ahead of their recent summit in Riyadh, Saudi Arabia.

The first report, Holistic Review of the March Market Turmoil, considers the nature of vulnerabilities in non-bank financial intermediation (NBFI) in light of the lessons learnt from the market disruption resulting from the COVID-19 pandemic.

FSB provided the G20 summit participants with another report, COVID-19 pandemic: Financial stability impact and policy responses, which considers the financial stability impact and policy responses to the COVID-19 economic fallout and examines financial stability developments since the G20's July meeting of finance ministers and central bank governors.

In the November letter to the governments and central banks of the 19 largest sovereign economies plus the EU, FSB Chair Randal Quarles wrote, "The shocks related to the COVID Event offer lessons for financial stability policy going forward." While noting that banks and financial markets were mostly able to absorb the shock, Quarles, who also serves as the US Federal Reserve's vice chair for supervision, wrote that "some stresses were intensified through impacts on non-bank financial intermediation (NBFI), which has come to play an increasingly important role in the financing of the real economy and managing the savings of households and companies."

The FSB's report on Holistic Review of the March Market Turmoil lays out an NBFI work program focusing on three main areas:

- work to examine and address specific risk factors and markets that contributed to amplification of the shock;
- enhancing understanding of systemic risks in NBFI and the financial system as a whole, including interactions between banks and non-banks and cross-border spillovers; and
- assessing policies to address systemic risks in NBFI.

FSB's analysis found that a "flight to safety" phase took place from late February to early March, when investors sold riskier assets and bought less risky ones. That was followed by a more acute phase in mid-March, the "dash for cash," as investors sold risky as well as relatively safe assets in an attempt to get cash.

In addition, on 16 December 2020, the FSB published its Global Monitoring Report on Non-Bank Financial Intermediation 2020 which sets out the outcomes of the FSB's annual monitoring exercise to assess global trends and risks in NBFI, covering 29 jurisdictions that account for 80% of global GDP. While the report is primarily based on end-2019 data (therefore pre-dating the COVID-19 pandemic), the trends examined contribute to an understanding of the wider background and shed light on some of the vulnerabilities that became apparent during the March market turmoil. The impact of the COVID-19 disruption on the NBFI sector in general and on money market funds (MMFs) specifically is explored in more detail in the context of two case studies.

FSB report on the implications of climate change for financial stability

On 23 November 2020, the Financial Stability Board (FSB) published a report on the implications of climate change for financial stability. The report examines the channels through which climate-related risks – physical and transition risks – could impact, or be amplified by, the financial system and the ways they might interact.

According to the report findings, current estimates of the impact of physical risks on asset prices seem to be relatively contained; they may, however, be subject to considerable tail risk. In particular, the materialisation of physical risks could lead to a sharp fall in asset prices and increase uncertainty. In addition, a disorderly transition to a low carbon economy could result in a destabilising effect on the financial system.

Climate-related risks may also affect the way the global financial system responds to disruptive events. In particular, they may give rise to abrupt increases in risk premia across a wide range of assets. This could have a number of knock-on effects, such as altering asset prices (co-)movement across sectors and jurisdictions; amplifying credit, liquidity and counterparty risks; and challenging financial risk management in ways that are difficult to predict. Such changes may undermine the effectiveness of certain approaches to risk diversification and management. This may in turn affect financial system resilience and result to a reduction in bank lending and insurance provision.

Financial institutions can take a number of steps to reduce or manage their exposure to climate-related risks; for example, integrating climate-related risks into their assessments of borrower credit risk and investment decisions, using metrics that track their exposures to climate risk and incorporating climate risk management into institution-wide governance, strategies and risk management frameworks.

The FSB points out that the effectiveness of the measures taken by financial institutions may be undermined by a lack of appropriate data and, therefore, risk management could benefit from initiatives to enhance information with which to assess climate-related risk.

In Focus

UK-EU Trade Agreement: What's next for financial services?

On 24 December 2020, after intensive down-to-the-wire negotiations, the European Commission and the UK government reached an agreement on the terms of future trade and cooperation between the EU and UK.

Trade and Cooperation Agreement

This Trade and Cooperation Agreement (the Agreement) outlines the future economic relationship between the EU and UK. A significant component of the Agreement is on free trade, ensuring that no tariffs or quotas are put in place for the cross-border trade of rule-compliant goods. The Agreement also puts in place a framework for cooperation on energy, transport, social security and standard-setting including in respect to climate change, labour rights and tax transparency.

One area where the Agreement is noticeably light on detail is in respect to financial services. As widely anticipated by the industry, the Agreement does not extend to banks, insurers and other financial services firms authorised in the UK an automatic right to access EU markets.

The end of passporting

Under a variety of European Directives and Regulations, UK financial services firms have been able to undertake regulated business in the EU (and vice versa) using so-called European financial services passports.

Provided firms were appropriately licensed and regulated in their home country, these firms could use either a services or branch passport to undertake their business across EU markets under the supervision of local EU Member State regulators without the need for a local presence and/or licence.

The UK left the EU on 31 January 2020 and entered into a transitional period where European law continued to apply until 31 December 2020. UK firms have been able to continue to rely on their European passports during this transitional period. The absence of equivalency decisions and the fact that the Agreement does not provide for broad-based market access rights means that now that the transitional period has ended UK firms no longer have automatic access to EU markets, whereas EU firms will continue to have access to the UK market for a further transitional period under the terms of the UK's temporary permissions regime.

Reflecting these concerns, the UK Prime Minister told the *Sunday Telegraph* that the Agreement "perhaps does not go as far as we would like" on financial services. The Chancellor of the Exchequer has sought to provide reassurance to the City of London in the *Times* noting the Agreement provides for a regulatory cooperative framework between the EU and UK while giving the UK the opportunity to regulate "a little bit differently" than it has done in the past.

Financial services in the Agreement

The Agreement commits both the UK and EU to maintain their markets as being open on a non-discriminatory basis to firms in the UK and EU provided these firms are appropriately established in the relevant country. The parties to the Agreement also commit to ensuring that internationally agreed standards in the financial services sector are implemented and applied in their territories.

Financial services are expressly excluded in the Agreement from the most-favoured nation clause in terms of any future trade deal with a third country. Financial services are also excluded from the provisions in the Agreement on services more generally and are also excluded from the requirement to review trade in services and investment relations in the future.

As noted by the Chancellor, both the EU and the UK committed in the Agreement to establishing a Memorandum of Understanding, by March 2021, for establishing a framework for regulatory cooperation on financial services. UK and EU regulators already have a range of memoranda of understanding. For example, the Financial Conduct Authority has a memorandum of understanding in place with the European Securities and Markets Authority (ESMA) as well as national EU regulators covering supervisory cooperation, enforcement and information exchange. The Agreement's proposed Memorandum of Understanding should build on the existing good work of EU and UK regulators in terms of fostering cooperation.

The Agreement commitment to a Memorandum of Understanding does fall short, however, of the provisions of other such free trade agreements. For example, the free trade agreement between the EU and Japan expressly put in place regulatory cooperation measures in the free trade agreement itself.

Unsurprisingly, both the UK and EU have also preserved their respective rights to put in place measures for prudential reasons (the "prudential carve-out"). This prudential carve-out permits the Bank of England and the European Central Bank to act independently of one another when acting to preserve financial stability and/or the integrity of financial markets.

What about equivalency decisions?

The Agreement does not include any decisions under equivalency frameworks for the financial services industry. Decisions on equivalency are unilateral decisions and not subject to negotiation. This is the case both for financial services and other areas such as data protection.

Generally, certain legislative frameworks in both the UK and the EU allow for third countries to be assessed as having "equivalent" legislative safeguards and standards. Where such a decision is reached, market access arrangements open up for firms to do cross-border business between the UK/EU and those third countries. From 1 January 2021, the UK will be considered a third country under EU law. Similarly, the UK will consider the EEA Member States as third countries for the purposes of market access. Under this framework, it is the European Commission and HM Treasury that may make such an equivalency decision about a third country's legislative framework.

In the absence of passporting rights, equivalency decisions are sometimes seen as a way of replicating the ease of cross-border business that previously was the status quo. The application of an equivalence

regime is a very different proposition to the ease of market access provided by passporting. Financial services are regulated by a range of laws across the EU with few containing substantive equivalence regimes which enable third country firms to provide services to local customers/counterparties without local authorisation. The ability of UK firms to operate in the EU under equivalency decisions and vice versa is much more limited than the soon-to-end passporting arrangements. Importantly, equivalency decisions may also be withdrawn unilaterally on very short notice.

Equivalency decisions to date

There are around 40 areas where the EU may consider the UK regulatory framework as equivalent in respect to financial services.

In September 2020, the European Commission made one such decision in respect to central counterparties (CCPs). ESMA then proceeded to determine that the three UK-based CCPs should be recognised as third country Central Counterparties (TC-CCPs). As TC-CCPs, they will continue to be eligible to provide their services in the EU after the end of the transition period on 31 December 2020.

In November 2020, HM Treasury announced that the UK would be granting a package of equivalence decisions to EEA states for certain intragroup transactions, regulated markets, market-making exemptions from short selling restrictions, the certification for credit rating agencies and under the Benchmarks regulation. These equivalency decisions will come into effect at the end of the transitional period.

In the Questions & Answers to the Agreement, the European Commission noted that it is currently assessing the UK's responses to the Commissions' equivalency questionnaires in 28 areas. According to the Commission, it is seeking further clarifications on how the UK will diverge from EU frameworks after 31 December 2020 and so, accordingly, cannot finalise its assessment at this time. Notably, the Commission acknowledged "the UK's equivalence decisions announced in November, adopted in the UK's interest. Similarly, the EU will consider equivalence when they are in the EU's interest."

Dialogue in respect to equivalency decisions

In 2018 the UK had floated the idea of a "mutual recognition" regime going well beyond the current piecemeal "equivalence" patchwork, but it was firmly rejected by the EU negotiators and did not gain traction.

Clause 1 of the accompanying Joint Declaration on Financial Services Regulatory Cooperation (Joint Declaration) stated that the EU and the UK would "establish structured regulatory cooperation on financial services, with the aim of establishing a durable and stable relationship between autonomous jurisdictions" which will allow for "transparency and appropriate dialogue in the process of adoption, suspension and withdrawal of equivalence decisions" and "enhanced cooperation and coordination."

The concern is that a unilateral withdrawal of an equivalency decision represents a significant cliff- edge for firms and their customers in the sector. The UK's position had been to propose an initial period of consultation on possible solutions to maintain equivalence, and then clear timelines and notice periods "appropriate for the scale of the change before it takes effect" rather than the present 30-day period. Additionally, the UK had proposed "a safeguard for acquired rights" and that intractable disputes between the UK and the EU would ultimately be resolved by independent arbitration.

It is to be hoped that these aspects of the Joint Declaration are incorporated into the terms of the Memorandum of Understanding mandated by the Agreement by March 2021. It remains possible, however, that EU concerns about the UK loosening regulations to its competitive advantage will result in the EU seeing the prospect of a unilateral withdrawal of equivalency decisions as an effective method of keeping the UK harmonised with the EU legal and regulatory framework.

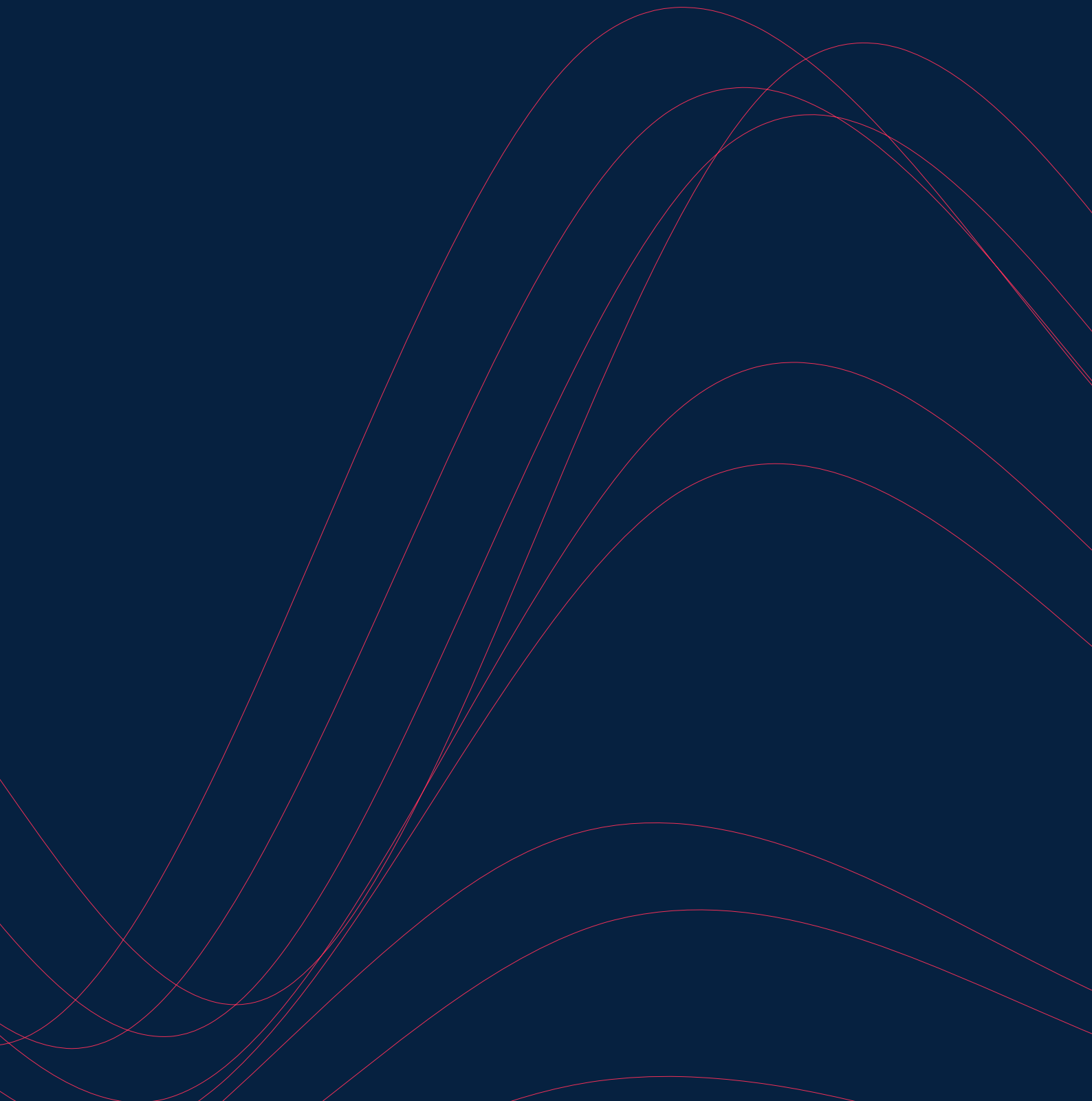
What's next for financial services?

The failure to replicate market access arrangements under passporting in the Agreement does not come as a surprise or shock to the financial services industry.

UK and EU firms, as well as national and pan-EU regulators, have been putting in place contingency measures to allow cross-border business to continue in the event that no agreement is reached.

In the UK, these measures have primarily consisted of a temporary permissions regime which allows EU firms to continue doing business in the UK without local authorisation for a period of time. No pan-EU temporary permissions regime exists for UK firms seeking continuity of business. Instead, UK firms have proceeded to either scale back their EU business, subsidiarise and seek EU Member State authorisation and access to passporting, or else rely on local EU27 national measures (such as overseas persons regimes, which exist in certain countries) and/or on conducting business with EU customers on a reverse solicitation basis.

As the transitional period ended on 31 December 2020, it appears highly likely that more friction in cross-border financial services will occur. The extent of that friction continues to depend on the willingness of regulators and governments to act on equivalence decisions, regulatory cooperation and the acknowledged shared interest in a vibrant financial services sector.



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