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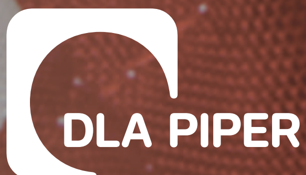
FINANCIAL SERVICES REGULATION

EXCHANGE – INTERNATIONAL NEWSLETTER



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INTRODUCTION

WELCOME

DLA Piper's Financial Services International Regulatory team welcomes you to Issue 34 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 EUROPEAN UNION, as well as contributions from the UK, the USA and CANADA.

Recent months have seen substantial developments in the regulatory space, with the introduction of PSD2, MiFID II and fine-tuning to the EU's capital requirements regime. For this month's issue, we have included an expanded "In Focus" section considering each of the PSD2 and MiFID II workstreams in more detail and providing an insight into the implementation status for each EU member state. Specifically, we consider the implementation of PSD2 at a European and UK level, including an analysis of the final EBA guidelines on security measures for operational and security risk. We also cover the implementation of MiFID II at a European and UK level, including an analysis of published technical standards and ongoing work around inducements.

In addition, we update you on recent developments in the rules regarding capital requirements, including a review of the final EBA guidelines on the introduction of IFRS 9 and the treatment of connected persons under the CRR. We look at global developments in the cryptocurrency and ICO space, the European Commission's impact assessment on a legislative proposal for an EU framework on crowdfunding, the EBA's recent consultation on EU stress testing mechanisms and proposals to extend the SMCR regime in the UK to insurers and other financial services firms. We also provide an update on key enforcement actions and case law in the financial services space, including recent developments in *PAG* v *RBS*, which is subject to appeal following the High Court's original decision on 21 December 2016, and FCA enforcement action in relation to market abuse, unauthorised investment schemes and LIBOR fixing.

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

February 2018

EUROPEAN UNION

EUROPEAN COMMISSION PUBLISHES A SUMMARY OF RESPONSES ON CROWDFUNDING AND PEER-TO-PEER FINANCE

On 28 November 2017, the European Commission published the responses received to its inception impact assessment, published on 30 October 2017, evaluating potential legislative proposals for an EU framework on crowdfunding and peer-to-peer (**P2P**) finance.

The overall aim of conducting this assessment is to foster initiatives which enable crowdfunding activity to grow. This can be achieved by making better use of the single market, enabling platforms to scale cross-border and providing them with a proportionate and effective risk management framework. In particular, the Commission aims to tackle problems around market fragmentation and lack of scale, as well as the perceived unreliability of crowdfunding and P2P platforms. The impact assessment highlighted that crowdfunding activities have to date been primarily confined to national markets with little or no cross-border activity. The Commission also cited the benefits of crowdfunding and P2P lending in providing finance for fast growing start-ups and SME firms and the subsequent benefits to employment and economic growth.

The impact assessment analysed whether EU action is warranted and focused on the following policy options: (i) a baseline scenario with no EU framework; (ii) building on reputational capital as part of a self-regulatory approach with minimum EU standards; (iii) setting out a comprehensive EU approach where crowdfunding platforms would be treated like regulated trading venues or payment institutions; and (iv) implementing a cross border solution with a standalone opt-in EU framework.

The European Commission received 41 responses to its impact assessment from a range of entities including the Association for Financial Markets in Europe, the European Savings and Retail Banking Group, the UK Crowdfunding Association and HM Treasury. This feedback is summarised below:

- some concern was expressed that the distinction between P2P lending and investment-based crowdfunding was not adequately addressed;
- a number of responses emphasised the importance of ensuring that any new regulatory framework was proportionate and did not impose significant additional cost;
- additional clarity was sought on how the proposed framework would interact with existing EU directives;
- the Association Française De L'Investissement Participatif highlighted the importance of ensuring that any regulatory regime would be competitive on a pan-European level, particularly in the context of Brexit; and
- HM Treasury drew attention to the FCA's bespoke regulatory regime for loan-based crowdfunding and requested that the Commission engages with the FCA as it develops its proposals. The UK also expressed concern that a less strict opt-in framework, if rolled out, could lead to regulatory arbitrage as companies sought to avoid existing national obligations.

The Commission noted that no further open public consultation is envisaged given its regular dialogue with European Supervisory Authorities, member states and the crowdfunding sector, and the fact it has conducted four public consultations on crowdfunding and P2P lending to date.

UK Updates on Crowdfunding and P2P Lending

On 21 December 2017, the UK Government released draft legislation amending the Financial Services and Markets Act 2000 (Carrying on Regulated Activities By Way of Business) Order 2001. The draft legislation clarifies the position of borrowers who raise funds through P2P lending platforms stating that "only firms whose core business involves borrowing through a peer-to-peer platform would need to obtain a banking license and be regulated as a "deposit taker"".

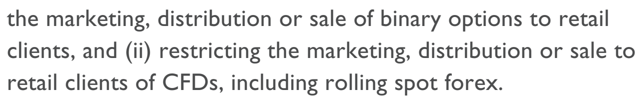
The FCA, in its 11 December 2017 paper entitled "Our Approach to Competition" cited its regulation of P2P lending as an example of its approach to balancing competition and innovation. The FCA has been increasingly active in this space during recent months, with a review of P2P marketing practices ongoing currently and a number of P2P platforms having already applied for and received authorisation.

As Andrew Bailey stated in an interview on 8 December 2017, "It's a fast-moving, evolving industry. Some of the directions in which it's going off are posing some quite big challenges in terms of transparency and fairness".

ESMA STATEMENT ON CFDS AND BINARY OPTIONS

15 December 2017, ESMA issued a statement expressing its concerns about the provision of speculative products such as some types of CFDs, including rolling spot forex, and binary options to retail clients and announced a range of measures it was considering in order to control or reduce the risks to retail investor protection.

ESMA stated it was considering the use of its product intervention powers under MiFIR in order to address its concerns about the provision of such products to retail clients, and in particular announced it was considering (i) prohibiting



the marketing, distribution or sale of binary options to retail clients, and (ii) restricting the marketing, distribution or sale to retail clients of CFDs, including rolling spot forex.

With reference to (ii) above, ESMA is currently reviewing the following restrictions:

- leverage limits on the opening of a position between 30:1 and 5:1, whose limit will vary according to the volatility of the underlying asset;
- a margin close-out rule;
- negative balance protection to provide a guaranteed limit on client losses;
- a restriction on benefits incentivising trading; and
- a standardised risk warning.

ESMA published a call for evidence on potential product intervention measures relating to the provision of CFDs, including rolling spot forex and binary options to retail investors on 18 January 2018. The submission period for responses will close after 5 February 2018. Any product intervention measure adopted by ESMA under Article 40 of MiFIR can last up to three months and the measures are renewable.

EU LIST OF NON-COOPERATIVE JURISDICTIONS FOR TAX PURPOSES PUBLISHED

On 5 December 2017, the EU Code of Conduct Group on Business Taxation (**Code Group**) published its list of non-cooperative jurisdictions for tax purposes.

This followed an intensive year-long screening process in which the Code Group analysed the tax legislation and policies of 92 non-EU jurisdictions against the criteria on tax transparency, fair taxation and implementation of the anti-Base Erosion and Profit Shifting (**BEPS**) standards (**Criteria**) endorsed by the Council of the EU on 8 November 2016.

The Code Group emphasised the importance of "promoting globally" the Criteria and reiterated the "crucial importance" the EU places on providing efficient mechanisms against the erosion of member states' tax bases through tax fraud, evasion and avoidance.

The Code Group confirmed that those jurisdictions named as non-cooperative would remain on the list until they meet the Criteria. The Code Group committed to engaging in discussions with them with a view to agreeing and monitoring remedial steps. A progress report is expected before summer 2018 for jurisdictions who have agreed remedial steps. The list of non-cooperative jurisdictions will be updated at least once per calendar year.

Non-cooperative jurisdictions listed in the report include American Samoa, Bahrain, Barbados, Grenada, Guam, Macao SAR, Marshall Islands, Mongolia, Namibia, Palau, Panama, the Republic of Korea (i.e. South Korea), Saint Lucia, Samoa, Trinidad and Tobago, Tunisia and the United Arab Emirates.

The Code Group confirmed that the Isle of Man, Jersey and Guernsey were cooperative tax jurisdictions and committed to working with these jurisdictions throughout 2018 to ensure that they maintain this status. As part of this process, the islands made commitments to address concerns raised by the Code Group around economic substance.

UPDATE ON VARIATION MARGIN REQUIREMENTS FOR PHYSICALLY SETTLED FX FORWARDS UNDER EMIR

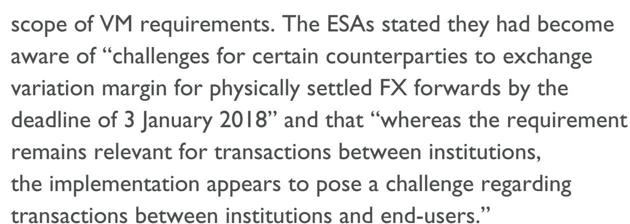
On 18 December 2017, the Joint Committee of the European Supervisory Authorities (**ESAs**) published a final report (**Report**) containing draft regulatory technical standards (**Draft RTS**) designed to amend the requirement to post variation margin (**VM**) for physically settled foreign exchange (**FX**) forwards to target only transactions between institutions (i.e. credit institutions, investment firms or equivalent third country entities).

The VM requirements for physically settled FX forwards under Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories (**EMIR**) came into force in the EU on 3 January 2018.

Even before the introduction of this requirement, however, there were concerns that an equivalent approach was not being taken in other key jurisdictions. In advance of the implementation date, the ESAs issued an earlier joint statement on 24 November 2017, announcing a review of the requirements and encouraging competent authorities (**CAs**) to adopt a proportionate approach to enforcement (**November Statement**). DLA Piper has provided comment on the November Statement on our website.

The solution developed by the ESAs in the Report is to limit the requirement to collect VM for physically settled FX forwards to transactions concluded between "institutions" within the meaning of the Capital Requirements Regulation (575/2013).

In producing the Report, the ESAs noted that "all other jurisdictions – such as the USA, Japan, Singapore and Canada" had not included physically settled FX forwards within the



scope of VM requirements. The ESAs stated they had become aware of "challenges for certain counterparties to exchange variation margin for physically settled FX forwards by the deadline of 3 January 2018" and that "whereas the requirement remains relevant for transactions between institutions, the implementation appears to pose a challenge regarding transactions between institutions and end-users."

The Draft RTS are designed to amend the existing regulatory technical standards (2016/2251) on risk mitigation techniques for OTC derivatives not cleared by a central counterparty to ensure a consistent implementation in the EU (**EMIR RTS**). The Draft RTS will enter into force on the day following its publication in the Official Journal of the EU.

Until this time, the ESAs have stated that "for institution-to-non-institution transactions, the competent authorities should apply the EU framework in a risk-based and proportionate manner until the amended RTS enter into force." In practice this should mean that competent authorities will not require end-users to post VM in the period from 3 January 2018 onwards.

ESMA INVESTMENT MANAGEMENT PRIORITIES FOR 2018

On 16 November 2017, Steven Maijoor, the Chair of the European Securities and Markets Authority (**ESMA**) gave a speech outlining ESMA's investment management priorities for 2018.

Mr Maijoor focused his speech on three key issues: (i) the costs and charges of investment funds; (ii) investment fund stress testing; and (iii) supervisory convergence in the context of Brexit. Each of these themes is considered in more detail below.

Costs and Charges of Investment Funds

Mr Maijoor noted that a key goal of the Capital Markets Union was to increase the attractiveness of long-term savings products for retail investors and that transparency of costs and performance of those products was seen as a key factor towards that goal. He noted that the European Commission had asked ESMA, together with the other European Supervisory Authorities, to issue recurring reports on the costs and past performance for the main categories of retail investment, insurance and pension products. He highlighted that ESMA had already begun this work and was analysing the impact of costs, including explicit and implicit fees, as well as the effect of inflation on investors' returns in EU Undertakings for the Collective Investment of Transferable Securities (**UCITS**).

In the view of Mr Maijoor, this work complements the regulatory changes introduced under the second Markets in Financial Instruments Directive (**MiFID II**) concerning payment for investment research. For example, Mr Maijoor highlighted the fact that this legislation will push portfolio managers to identify more clearly the research needed and the value it adds in informing their investment decisions. Mr Maijoor also cited ESMA's action in tackling closet indexing, its planned analysis of active and passive funds and its work on supervisory convergence in relation to performance fees.

Stress Testing

Mr Majioor noted that stress testing (see below for further information) had been identified as an instrument for funds and supervisors to monitor resilience "in light of severe but plausible shocks". He recognised that stress testing was particularly important in identifying risks and focusing supervisory resources in the most effective way, particularly as risks in the investment fund sector were characterised by major uncertainties regarding the nature of risk, the scenarios, the type of entities that could trigger or amplify shocks and the contagion effects to investors and financial entities. To address this, ESMA is developing an operational framework for the identification and quantification of potential industry and macro risks that can be used in stress simulations.

Mr Maijoor also drew attention to ESMA's plan to publish a package of measures in the context of the Money Markets Funds Regulation (see below for further information) and provide more general guidance on stress testing practices covering UCITS and Alternative Investment Funds.

Brexit

Mr Maijoor noted that the UK's stated intention to withdraw from the EU and the single market along with the potential that this could result in a shift of entities and activities from the UK to the EU27 gave rise to concerns about regulatory arbitrage as the remaining EU27 states compete to win business. He emphasised ESMA's commitment to avoiding this scenario. He also noted that he considers the opinions ESMA issued in relation to Brexit to be fully in line with existing Level 1 requirements and that these opinions in no way undermine the freedom of establishment provided by relevant EU legislation or question the delegation model adopted by a number of EU funds. ESMA is confident that its opinions provide a "sound basis with which to promote supervisory convergence as the securities markets industry adjusts to the UK's withdrawal".

ESMA SPEECH PROVIDING FURTHER DETAIL ON ASSET MANAGEMENT SECTOR PRIORITIES IN 2018

On 5 December 2017, Verena Ross, ESMA Executive Director, delivered a speech in which she touched on the relevant developments during 2017 and outlined a number of priorities for ESMA looking ahead to 2018. The speech was primarily focused on issues relating to Brexit, money market funds and MiFID II.

Brexit

Ms Ross noted that, to date, ESMA's work on Brexit has concentrated on supervisory convergence. In Ms Ross' view, the opinions which ESMA has presented are "fully in line with existing level 1 requirements", "in no way undermine the freedom of establishment that is provided by the relevant EU legislation" and "do not call into question the delegation model". In this, she was consistent with the views expressed by Mr Steven Maijoor, ESMA's Chair, in November (see above).

While Ms Ross recognised the usefulness of these opinions, she noted that ESMA had also set up a Supervisory Coordination Network to allow experts from national competent authorities a forum to discuss cases involving UK entities looking to move to the EU27. Ms Ross suggested that ESMA could potentially further facilitate agreements on behalf of national regulators in the EU27, as it did at the time AIFMD came into force.

Money Market Funds

Ms Ross drew attention to the three main deliverables in the final Money Market Funds (**MMF**) Regulation (see below for additional information). These include technical advice on Level 2 measures, implementing technical standards on the reporting requirements and guidelines on stress testing, each of which is considered below.

- Technical advice: A number of qualitative and quantitative factors have been set out for MMF managers to consider in relation to the eligibility of assets for reverse repurchase agreements. Existing methodologies for assessing credit quality have also been developed to suit the MMF sector.
- Implementing technical standards on reporting requirements: ESMA intends to ensure that the final set of reporting requirements are more targeted at the MMF sector and as consistent as possible with existing AIFMD reporting requirements.
- Guidelines on Stress Testing: ESMA had chosen not to specify reference parameters in the current version of the final guidelines given the difficulty in providing precise figures on the calibration of the different criteria due to changing market conditions and the diversity of participants in the sector.

Ms Ross' speech also touched on the issue of costs and charges, highlighting key ESMA workstreams in this space in the Capital Markets Union initiative, closet indexing, analysis of the performance of active and passive funds, and performance fees.

MiFID II

Ms Ross drew attention to the ban on inducements and its impact on the provision of investment research and the requirement for legal entity identifiers (**LEIs**). Ms Ross emphasised that the new model of payments for research, as opposed to payments for execution, should push portfolio managers to identify more clearly the research they need and the value it adds in informing their investment decisions. She also stressed that investment firms and trading venues should make necessary efforts to obtain their LEIs in good time.

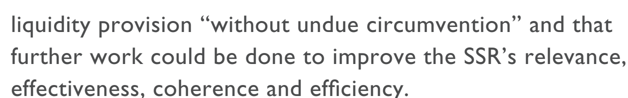
On 20 December 2017, ESMA subsequently confirmed it would implement a 6 month transitionary period on the LEI requirement for non-EU issuers and firms receiving transaction reports that had no LEI code in place, provided certain conditions were met (see MiFID II updates below for further detail).

ESMA FINAL REPORT AND TECHNICAL ADVICE ON EVALUATION OF CERTAIN ELEMENTS OF THE SHORT SELLING REGULATION

On 21 December 2017, the European Securities and Markets Authority (**ESMA**) published its final report (**Report**) containing technical advice for the European Commission on the evaluation of certain elements of the Short Selling Regulation (236/2012) (**SSR**).

The Report was issued following the consultation paper published by ESMA on 7 July 2017. The final report provides ESMA's technical advice on the exemption for market making activities, the short term restrictions on short selling in case of a significant decline in prices and the transparency of net short positions and related reporting and disclosure requirements.

In the Report, ESMA proposed a number of key amendments in these areas. For example, the introduction of reporting obligations for market makers, transforming current bans on short selling into a ban on entering into or increasing net short positions and requiring legal entity identifiers for the identification of certain position holders. In particular, ESMA noted that the complete exemption for market makers from reporting requirements under article 17 of the SSR provided regulators with a limited data set with which to assess whether the market making exemption allows for



liquidity provision "without undue circumvention" and that further work could be done to improve the SSR's relevance, effectiveness, coherence and efficiency.

ESMA noted that its advice is designed to contribute to the actions announced by the Commission in its communication on the call for evidence published on 23 November 2016.

CAPITAL REQUIREMENTS – RECENT DEVELOPMENTS

There have been a number of developments in relation to the Capital Requirements Regulation (575/2013) (**CRR**) and Capital Requirements Directive (2013/36) (**CRD IV**) during recent months. We summarise some of these updates below.

IFRS 9

On 12 December 2017, the EU adopted Regulation (2017/2395) (**IFRS 9 Regulation**), which amends the CRR to provide for transitional arrangements to mitigate the impact of IFRS 9, which was adopted in the EU on 22 November 2016, in relation to own funds and large exposures of certain public sector exposures denominated in the domestic currency of any Member State.

The IFRS 9 Regulation inserts a new Article 473a into the CRR, which includes provisions on transitional arrangements for the introduction of IFRS 9 and IFRS 9-like expected credit loss models (**Analogous ECLs**) in order to mitigate the impact of the impairment requirements resulting from IFRS 9 on capital and leverage ratios, and imposes disclosure requirements on institutions that apply transitional arrangements for IFRS 9 and Analogous ECLs.

The final EBA guidelines on uniform disclosure of IFRS transitional arrangements under the CRR were published on 12 January 2018, and will apply from 20 March 2018 until the end of the transitional period, which finishes on 20 March 2023.

Final EBA guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures under the IRB approach

On 20 November 2017, the European Banking Authority (**EBA**) published its final guidelines on probability of default (**PD**) estimation, loss given default (**LGD**) estimation and the treatment of defaulted exposures (**IRB Guidelines**), as part of its general review of its Internal Ratings Based (**IRB**) models approach under the CRR.

The IRB Guidelines are designed to address the discrepancies identified by the EBA in the methodologies underlying risk estimates, which have arisen due to the flexibility of the IRB framework.

The IRB Guidelines seek to align terminology and definitions, particularly in relation to key concepts underlying the estimation of risk parameters, including in relation to default rate and realised LGD. The IRB Guidelines also seek to clarify the application of certain regulatory requirements and specify principles for the estimation of risk parameters.

The EBA has recognised that the IRB Guidelines may lead to material model changes for some institutions, and therefore is proposing a deadline for full compliance to be the end of 2020, although the EBA states that it expects preparations for implementation should begin "immediately".

EBA consults on methods of prudential consolidation

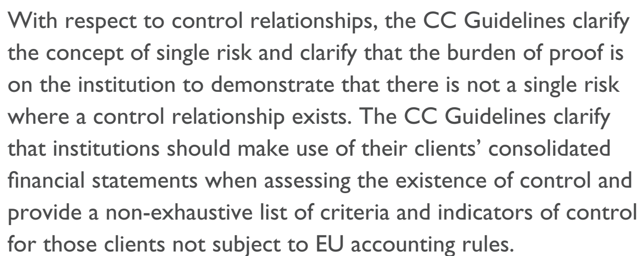
On 9 November 2017, the EBA published a consultation paper setting out draft regulatory technical standards (**Draft Consolidation RTS**) on the methods of prudential consolidation under the CRR and entities which may give rise to a step in risk.

The Draft Consolidation RTS elaborate on some of the conditions, criteria and indicators which may allow the application of a different method of consolidation than full consolidation under Article 18(1) CRR, including proportional consolidation or the aggregation method, or the application of the equity method. The Draft Consolidation RTS also includes indicators that should be assessed when institutions are seeking to identify which undertakings may bear a step in risk, based on the Basel Committee on Banking Supervision (**BCBS**) guidelines from October 2017.

At the time of writing, the consultation is expected to close on 9 February 2018, with the final draft RTS submitted to the Commission for endorsement thereafter.

Final EBA guidelines on treatment of connected persons under CRR

On 14 November 2017, the EBA published its final report setting out guidelines on the definition of connected clients under the CRR (**CC Guidelines**), and particularly focus on the circumstances under which an institution's clients would be regarded as constituting a group of connected clients (**GCCs**) under control and economic dependency relationships.



With respect to control relationships, the CC Guidelines clarify the concept of single risk and clarify that the burden of proof is on the institution to demonstrate that there is not a single risk where a control relationship exists. The CC Guidelines clarify that institutions should make use of their clients' consolidated financial statements when assessing the existence of control and provide a non-exhaustive list of criteria and indicators of control for those clients not subject to EU accounting rules.

In relation to economic dependencies, the CC Guidelines state that if institutions can demonstrate that financial difficulties of one client would not lead to the funding or repayment difficulties for another client, the clients would not be considered as a single risk. The CC Guidelines also present a non-exhaustive list of situations that should be considered by institutions when assessing economic dependencies.

The CC Guidelines consider the potential for control and economic dependency relationships to interlink to create a GCC, and emphasise that the fundamental concept is that of single risk, regardless of the type of connection which caused it.

The CC Guidelines also set out control and management procedures for identifying GCCs and state the EBA's expectation that institutions identify all control relationships and take reasonable steps and use readily available information to investigate and identify economic dependencies among their clients.

Competent authorities have two months from publication of the translations of the CC Guidelines to indicate whether they will comply with them. The CC Guidelines will apply from 1 January 2019.

SECURITISATION REGULATION AND CRR AMENDMENT REGULATION IN FORCE

On 17 January 2018, Regulation (2017/2402) (**Securitisation Regulation**) and Regulation (2017/2401) (**CRR Amendment Regulation**) entered into force, and will apply from 1 January 2019. The Securitisation Regulation lays down common rules for securitisation, creating a European framework for simple, transparent and standardised (**STS**) securitisation while the CRR Amendment Regulation ensures that the effects of these changes are reflected in a firm's capital treatment under Regulation (575/2013), the Capital Requirements Regulation (**CRR**).

The Securitisation Regulation sets out a legal framework for securitisation in the EU. It defines securitisation and imposes various risk-retention, due-diligence and transparency obligations on the parties involved. It also contains the rules for selling securitised products to retail investors, a prohibition on re-securitisation, the requirements for securitisation special purpose entities and securitisation repositories as well as the framework for STS securitisation.

The CRR Amendment Regulation sets out the rules on capital treatment of securitised products, with STS securitisations attracting lower capital charges than non-STS securitisations. It also provides for the hierarchy of methodologies for calculating capital and establishes the risk-weight floors and caps. The CRR Amendment Regulation replaces the existing provisions in the CRR relating to the regulatory capital treatment of securitisation exposures held by institutions in the EU.

The reforms introduced by the Securitisation Regulation and CRR Amendment Regulation are part of the European Union's Capital Markets Union plan adopted in September 2015.

On 19 December 2017, the European Securities and Markets Authority (**ESMA**) issued three consultation papers seeking feedback on draft regulatory technical standards relating to:

- the requirements for the third parties seeking authorisation to provide STS verification services (ESMA33-128-108);
- disclosure requirements, operational standards and access conditions (ESMA33-128-107); and
- the format and content of STS notifications, and the information for assessing whether securitisation complies with STS criteria (ESMA33-128-33).

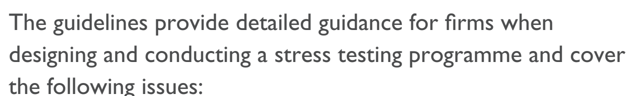
The consultations will be open for feedback until 19 March 2018. ESMA intends to finalise the draft technical standards, and expects to publish its final report on the STS notification and third party application requirements in July 2018, and its report on reporting requirements and operational standards/access conditions by the end of 2018.

DEVELOPMENTS IN EU STRESS TESTING

Following the 2016 EU-wide stress test, the European Banking Authority (**EBA**) has been working to update and develop the relevant methodology, guidelines and templates for the upcoming 2018 stress testing exercise. The ongoing workstream is discussed in more detail below.

EBA consulted on draft guidelines on stress testing

Under Article 100(2) of the Capital Requirements Directive IV Directive 2013/36 (**CRD IV**), the EBA is required to issue guidelines to enable competent authorities to use common methodologies in annual stress tests. To fulfil this obligation, on 31 October 2017, the EBA published a consultation paper setting out its draft guidelines on institutions' stress testing.



The guidelines provide detailed guidance for firms when designing and conducting a stress testing programme and cover the following issues:

- the taxonomy of stress testing;
- the description of types of stress test exercises;
- the reverse stress testing process for regular stress testing and recovery planning purposes; and
- additional risk areas, including credit and counterparty risk, liquidity risk and conduct risk.

The draft guidelines also contain the feedback received in a previous consultation by the EBA, as well as set out the policy decisions taken in response.

The consultation closed on 31 January 2018, and the EBA intends to finalise the guidelines in the first quarter of 2018 and begin applying them in the second quarter of 2018. These new guidelines will repeal and replace the guidelines on institutions' stress testing, issued by the Committee of European Banking Supervisors in 2010.

EBA consulted on revised guidelines on common supervisory procedures and methodologies for SREP and supervisory stress testing

On 31 October 2017, the EBA published a consultation paper setting out its draft guidelines on the revised common supervisory procedures and methodologies for the supervisory review and evaluation process (**SREP**) and supervisory stress testing under Article 107(3) of the CRD IV.

The consultation sets out the proposed changes to the EBA's current guidelines on common supervisory procedures and methodologies for SREP. The revisions made by the EBA are designed to reflect developments affecting the SREP framework since the original guidelines were finalised, including the introduction of Pillar 2 Capital Guidance and the integration of supervisory stress testing requirements.

The revisions to the guidelines refine and introduce the following:

- Pillar 2 capital guidance;
- supervisory stress testing and the supervisory assessment of institution's stress testing;
- the alignment of supervisory assessment of interest rate risk in the banking book (**IRRBB**) with the revision of the EBA's guidelines on IRRBB;
- scoring framework;
- interaction between SREP elements;
- the articulation of total SREP capital requirements and overall capital requirements and communication of supervisory capital expectations to institutions; and
- consistency with recently published legislation on internal governance.

The deadline for responses was 31 January 2018. The EBA intends for the revisions to apply from 1 January 2019, in time to be used in the 2019 cycle of SREP and joint decisions on institutions' specific prudential requirements.

EBA confirms methodology and templates for 2018 EU-wide stress test

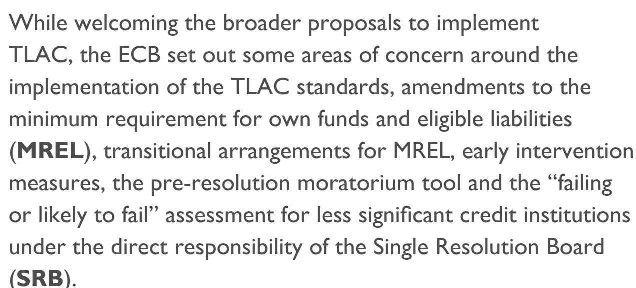
On 17 November 2017, the EBA published the final methodology to be used in the 2018 EU-wide stress test. The EBA is required to run EU-wide stress tests to assess the resilience of financial institutions to adverse market developments. The consultation on draft methodology took place in June 2017.

The methodology is designed to provide banks with adequate guidance and support for conducting the stress test exercise that was formally launched in January 2018. The methodology covers all relevant risk areas and, for the first time, incorporates International Financial Reporting Standard 9 (**IFRS 9**) accounting standards, which are covered in more detail above.

The EBA explained that the 2018 EU-wide stress test is primarily focused on assessing the impact of risk drivers on the solvency of banks. The results of the stress test are expected to be published by 2 November 2018.

ECB OPINION ON THE IMPLEMENTATION OF TLAC RULES

The European Central Bank (**ECB**) published an opinion dated 8 November 2017 on the European Commission's legislative proposals to implement the Financial Stability Board's (**FSB**) total loss absorbing capacity (**TLAC**) standard.



While welcoming the broader proposals to implement TLAC, the ECB set out some areas of concern around the implementation of the TLAC standards, amendments to the minimum requirement for own funds and eligible liabilities (**MREL**), transitional arrangements for MREL, early intervention measures, the pre-resolution moratorium tool and the "failing or likely to fail" assessment for less significant credit institutions under the direct responsibility of the Single Resolution Board (**SRB**).

In light of its concerns, the ECB set out suggested amendments to the Bank Recovery and Resolution Directive, Single Resolution Mechanism, the Capital Requirements Directive and Capital Requirements Regulation in a technical working document attached to the opinion.

BASEL III: EU RESPONSE TO THE FINAL POST-CRISIS REFORMS

On 7 December 2017, the Basel Committee of Banking Supervision (**BCBS**) finalised the remaining Basel III regulatory reforms and published their content in a document entitled "Basel III: Finalising post-crisis reforms". The EU authorities published statements on these reforms shortly after the BCBS issued its press release.

The majority of provisions within the Basel III reforms will be introduced on 1 January 2022, with requirements on output floors to be phased in from this date.

The announcements by the European Commission and the European Banking Authority (**EBA**) are summarised below.

European Commission to consult on final Basel III standards

The European Commission (**Commission**) published a press release on 7 December 2017 welcoming the announcement by the BCBS and announcing its plans to consult on the Basel III regulatory standards.

The Basel III framework sets global minimum standards for the amount of capital which banks must hold to cover the risks that they are exposed to. In the press release, the Commission explained that, in order to implement these standards in the EU, current banking regulations like the Capital Requirements Regulation (575/2013) (**CRR**) will need to be amended. The Commission stated that before proposing any amendments, it planned to launch a consultation and carry out an impact assessment to examine the effect of implementing Basel III on the EU economy.

The Commission stressed that any such future legislative proposals will be independent from the CRR amendments it had adopted in November 2016 and which were being negotiated by the European Parliament and the Council of the EU.

EBA Basel III impact assessment

On 7 December, the EBA published a monitoring report setting out the impact of Basel III reforms on the EU banking system. This report was soon followed by a more detailed ad hoc cumulative impact assessment (**Impact Assessment**) on 20 December 2017.

The Impact Assessment was based on December 2015 data and analysed the overall impact of the final Basel III reform package on 88 EU institutions from 17 member states. The EBA published the following findings:

- EU banks' minimum tier 1 capital requirement would increase by 12.9% at the full implementation date (14.1% for the large and internationally active banks and 3.8% for all other banks);
- EU banks would need EUR17.5 billion of additional common equity tier 1 capital and the total capital shortfall would be EUR39.7 billion;
- 20.5% of the banks in the sample would be constrained by the output floor, set by the BCBS at 72.5% of the standardised approach requirements; and
- the aggregate output floor was the strongest driver of the increase in minimum regulatory capital, whereas the revisions to the credit risk and operational risk frameworks had had a more moderate impact.

The EBA recognised that using the data from 2015 meant that the analysis did not "reflect bank-level changes in capital, portfolio composition and adjustments to business models" that had occurred since then. It also noted that the full implementation of the Fundamental Review of the Trading Book was assumed for the purposes of Impact Assessment.

ESMA PUBLISHES TECHNICAL ADVICE, ITS AND GUIDELINES ON MMF REGULATION

On 17 November 2017, ESMA published a final report (dated 13 November 2017) providing technical advice, draft implementing technical standards (**ITS**) and guidelines under the Regulation on Money Market Funds (2017/1131) (**MMF Regulation**). The final versions of these implementing tools are set out in Annex III to ESMA's report.

The report provides a summary of the feedback provided to the ESMA consultation paper published on 24 May 2017 and sets out ESMA's response. It contains draft technical advice under Articles 15 and 22 of the MMF Regulation relating to (i) quantitative and qualitative liquidity requirements and quantitative and qualitative credit quality requirements; (ii) criteria for validation of the credit quality assessment methodology; (iii) criteria for qualification of the credit risk, and of the relative risk of default of an issuer and of an instrument; (iv) criteria for estimating qualitative indicators on the issuer of the instrument; and (v) meaning of material change.

The draft ITS contain a set of templates to be used by managers of money market funds when reporting to competent authorities. ESMA confirmed that managers will not need to send quarterly reports, as required under Article 37 of the MMF Regulation, to National Competent Authorities (**NCAs**) immediately upon the MMF Regulation entering into force, i.e. July 2018, but the requirement will only kick in in October/November 2019. Managers will not be required to retroactively provide data for any period prior to this starting date. As a next step, ESMA promised to begin work on the guidelines and IT guidance in order for MMFs to have all the necessary information before submitting the reports to the NCAs.

The guidelines published in the final report provide the competent authorities and market players with details about stress test scenarios under Article 28 of the MMF Regulation. In particular, they include guidance on the establishment of common parameters of the stress test scenarios in relation to hypothetical events like a change in interest rates or occurrence of macro systemic shocks. ESMA stated that, in addition to the stress tests required under sections 5.1 to 5.7 of the guidelines, managers of MMFs should also conduct common reference stress test scenarios. The results of these will have to be reported to NCAs as described under Article 37 of the MMF Regulation. As in the case of the ITS mentioned above, ESMA will update the guidelines in good time before the submission of the necessary reports to the NCAs. The calibrations of the common reference stress test scenarios will be specified with the guidelines update.

ESMA submitted the technical advice and ITS to the European Commission, who then, on 16 January, launched a consultation which closed for comments on 12 February 2018. The MMF Regulation will enter into force on 21 July 2018.

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UNITED KINGDOM

DEVELOPMENTS FOLLOWING THE HIGH COURT DECISION IN PROPERTY ALLIANCE GROUP V ROYAL BANK OF SCOTLAND

The appeal to this case begins on 29 January 2018.

The High Court originally ruled in favour of the Royal Bank of Scotland (**RBS**) on 21 December 2016 in a claim relating to the selling of interest rate swaps, the conduct of RBS's global restructuring group (**GRG**) division and LIBOR manipulation. The case is significant, not least because it was the first major civil suit involving allegations of LIBOR manipulation to reach trial, and has generated significant political interest following the FCA's refusal to published its full skilled persons report on its investigation into RBS's GRG and Vince Cable's recent use of parliamentary privilege to name one of the GRG management team allegedly responsible for some of the practices in the group.

The case, PAG v RBS [2016] EWHC 3342 (Ch), was brought by the Property Alliance Group (**PAG**), a property investment and development business, who acquired four interest rate derivative products between 2004 and 2008. PAG alleged that RBS had (i) mis-sold the interest rate swaps, (ii) breached its duty of good faith and abused its contractual discretions and (iii) breached implied representations with respect to the setting of LIBOR.

Asplin J held that in the absence of an advisory relationship, RBS did not owe a duty of care wider than the duty to take reasonable care not to mis-state the facts. In addition, the Court held that there was no duty to provide a scenario analysis or reveal the extent of break costs, and that the term under the loan facility which required PAG to enter into interest rate hedging did not give rise to an implied term that the swaps would be suitable.

The second claim was dismissed after the Court found no implied term of good faith in the agreements between the parties. The judge held that the alleged implied term imposing limitations on RBS's exercise of contractual discretion did not arise as RBS was exercising either absolute contractual powers or making decisions where no contractual power or discretion arose. The Court further held that even if the above terms were implied, it would not have found that RBS had breached such terms by acting in bad faith or irrationally.

The third claim was dismissed on the basis that, in order for there to be an implied representation there had to be some positive words or conduct by RBS from which the representation about how LIBOR was set could be inferred and that, even if this were not the case, a reasonable representee would not have drawn the inferences alleged. Furthermore, the Court held that PAG did not rely on the alleged representations when it entered into the swaps, RBS had not been subject to any regulatory sanction specifically involving trader manipulation or low balling of GBP LIBOR, and PAG could not show that the relevant individuals at RBS intended to rely on the LIBOR representations.

In October 2017, the FCA published a summary of its FCA skilled person report into RBS's GRG and its treatment of small businesses, but refrained from publishing the full report which included a section relating to the bank's management team. Failure to publish the full report led to criticism from some quarters of the political establishment, and on 18 January 2018, Vince Cable, MP for Twickenham, used parliamentary privilege to name one of the management team allegedly responsible for the RBS's approach during this period.

As part of its drive to assist small businesses, the FCA published a consultation on 22 January 2018 on proposals to give more SMEs access to the Financial Ombudsman Service. The FCA is asking for response to the consultation by 22 April 2018 and intends to publish a policy statement making final rules in summer 2018.

RECENT DEVELOPMENTS IN FCA POLICY ON CFDS AND BINARY OPTIONS

During the past few months, a number of regulatory developments have taken place in relation to binary options and contracts for difference (**CFDs**). We summarise the most significant developments below.

FCA warns consumers about the risks of investing in cryptocurrency CFDs

On 14 November 2017, the FCA published a consumer warning about investing in cryptocurrency CFDs. The regulator informed consumers that cryptocurrencies, which are increasingly being marketed to them as an underlying investment, are in fact extremely high-risk, speculative products.

CFDs were described by the FCA as complex financial instruments which allow investors to speculate on the price of an asset. These are often offered with leverage, thereby amplifying the impact of price changes and significantly increasing not only profits but also losses, even to an extent exceeding the capital invested.

The FCA noted their concerns around price transparency, leverage, charges, funding costs, and price volatility. The FCA also pointed out that firms offering cryptocurrency CFDs must be authorised and supervised by the FCA, which allows investors access to the Financial Ombudsman Service (**FOS**) and the Financial Services Compensation Scheme (**FSCS**). However, the FCA stated that these safeguards do not protect investors against

or compensate them for trading losses and therefore suggested that only "experienced investors with sophisticated knowledge of financial markets" should consider investing in such products.

FCA warns consumers about the risks of investing in binary options

On the same date, 14 November 2017, the FCA published a similar consumer warning about the risks of binary options and highlighted the risk of consumers being targeted by binary options scams.

Binary options provide investors with opportunities to bet on the price of assets, often on very short timeframes (between 30 seconds and 5 minutes). The FCA's findings suggest that consumers "find it difficult to make sustained profits" and that the majority of consumers lose money using binary options. The FCA specifically highlighted risks in relation to trading losses, difficulties with making informed decisions, conflicts of interest between the firms offering binary options and investors, the addictive nature of short-term bets, and the potential for fraud.

From 3 January 2018, UK firms offering binary options must be authorised by the FCA. The customers of the firms subject to the UK regulatory regime will benefit from the FOS and the FSCS. As in the case of CFDs, the FCA pointed out that these protections do not extend to compensating any losses from trading, and that investors must carefully consider whether binary options are an appropriate choice for them.

FCA issues a "Dear CEO" letter regarding CFDs

On 10 January 2018, the FCA issued a "Dear CEO" letter to firms offering and distributing CFDs. In the letter, the regulator shared findings from its previous review and urged the firms to consider whether they comply fully with the regulatory requirements.

The review examined the conduct of firms that provide and distribute CFDs and deal with consumers, covering 34 organisations in total. The review revealed several matters of concern, including the following:

- most providers and distributors could not offer a satisfactory definition of their target market or explain how CFDs aligned with the interests of this group;
- the majority of retail customers (76%) who bought CFD products between July 2015 and June 2016 have lost money;
- a range of the firms' communication, monitoring and challenge practices were ineffective and below the standard expected by the FCA;
- most firms in the sample had flawed distributor due diligence processes;
- all of the distributor firms assessed had weaknesses in their conflict of interest management arrangements;
- while most firms had management information and monitoring structures in place, the flaws in these tools undermined their ability to challenge poor conduct and control failings. Some firms had no evidence of management information or key performance indicators;
- there was significant scope for improvement in the quality of remuneration arrangements in many of the CFD distributors examined; and
- several distributor firms had problems with the criteria for categorising clients as elective professionals.

The review uncovered "areas of serious concern" and the FCA findings suggest that some CFD providers and distributors may be in breach of the FCA Principles for Businesses, the Client's Best Interests rule and Senior Management Arrangements, Systems and Controls rules. The review identified a CFD provider whose arrangements were so poor that further action (i.e. enforcement) may be taken. The FCA called on the firms to examine, in light of these findings, whether they satisfy all relevant regulatory requirements, and to pay specific attention to the FCA's new Product Intervention and Product Governance sourcebook, which implements the product governance rules of the revised Markets in Financial Instruments Directive.

FCA APPROACH TO THE USE OF ARTIFICIAL INTELLIGENCE IN FINANCIAL MARKETS

On 11 October 2017, Bob Ferguson, the Head of the FCA's Strategy and Competition Division, delivered a speech on the automation of investment advice in financial markets.

In the speech, Mr Ferguson noted that the FCA sees automated advice as a valuable vehicle to help tackle the issues faced by consumers who are underserved by more traditional advice models, as well as a means of promoting competition in the UK financial advice market. He noted that automation could make the provision of advice and guidance to the mass market more cost-effective, as well as assist in addressing consumers' lack of confidence in making investment decisions. Both these issues were identified in the 2016 Financial Advice Market Review.

Mr Ferguson acknowledged that automated advice did bring risks, notably the fact that a poorly designed model could lead to "systemic mis-selling". With this in mind, the FCA Advice Unit has been set up to provide regulatory feedback to firms who feel

they struggle in developing an automated model and assist in the development of general tools that all firms providing advice to consumers can access.

In a broader context, the push towards greater automation can also be seen in the regulatory reporting space. On 1 November 2017, the FCA published a new webpage on model-driven machine-executable regulation reporting.

If implemented, model-driven machine-executable regulation reporting could benefit firms and regulators by improving the accuracy of data submissions, reducing costs, promoting competition and facilitating a more rapid implementation of regulatory requirements. Following the publication of the webpage, the FCA and Bank of England conducted a two-week "TechSprint", in which start-ups, regulated firms, technology providers and academics were brought together to explore potential technological solutions which could deliver model-driven machine-readable regulation.

FCA AND PRA CONSULT ON FIRMS' AND INDIVIDUALS' TRANSITION TO THE SMCR

FCA Consultation

On 13 December 2017, the FCA published a technical Consultation Paper (**CP17/40**) on the extension of the Senior Managers and Certification Regime (**SMCR**) to the entire financial services industry. CP17/40 contains the proposals for transitioning the FCA firms and individuals to the SMCR as well as the anticipated timelines for the changes.

CP17/40 follows a prior FCA Consultation Paper (**CP17/25**) published in July 2017. CP17/25 contained the FCA's initial proposals and draft rules on extending the SMCR to all FCA solo-regulated firms.

The FCA proposals in CP17/40 include automatically converting most of the senior persons currently covered by the Approved Persons Regime at Core and Limited Scope firms into the Senior Management Functions. A conversion notification form will nevertheless have to be submitted if the Core or Limited Scope firm has a non-executive director performing the role of the Chairman. Enhanced firms, on the other hand, will have to put more stringent requirements in place, including being required to submit conversion notification forms, Statements of Responsibilities and a Responsibilities Map for the purposes of transitioning to the new regime. The difference reflects the FCA policy of taking a proportionate approach to the rollout of SMCR, requiring "little or no interaction with the FCA" for most Core or Limited Scope firms.

The precise timetable for when the new rules become effective is not yet fixed and will be set by the Treasury in due course. The FCA proposed that the regime would apply to insurers from late 2018 and to solo-regulated firms from mid-to-late 2019. It also proposed to give the firms an extra 12 months to certify employees as fit and proper for the purposes of the Certification Regime.

The consultation will run until 21 February 2018. The FCA will consider the feedback it receives and will publish the final rules in a Policy Statement in summer 2018.

PRA Consultation

On the same date, 13 December 2017, the PRA published a consultation paper (**CP28/17**) setting out equivalent proposals to implement the SMCR extension to insurers. Firms and individuals are advised to read both documents in conjunction with one another. Consultation paper CP28/17 complements consultation paper CP8/17, which proposed optimisations to the Senior Insurance Managers Regime (**SIMR**) currently in place, and consultation paper CP14/17, which proposed the extension of the SMCR to insurers. The PRA, however, notes that "the proposals in CP28/17 do not pre-empt its consideration of responses to CP14/7 or other proposals recently published for consultation".

Consulation Paper CP28/17 contains proposals on a number of topics, including:

- amendments to Part 4A Permission forms and the rationalisation of the existing SMCR/SIMR forms towards the production of a streamlined set of forms for both banks and insurers that do not distinguish between firm types, bringing the overall number of forms down from 26 to 11;
- implementation of the extension of SMCR to insurers, including some transitional arrangements and changes to references to the existing SIMR and Senior Insurance Management Functions;
- the process for transferring from an SMF at an insurance firm to a banking firm; and
- the removal of gender-specific language from the regime.

Similarly to the FCA consultation, the PRA will be accepting comments until 21 February 2018. The commencement date for the extended SMCR will be prescribed by HM Treasury at a later date. The PRA currently works on the assumption that the extension will take place in the course of 2018 and proposes to publish the final policy and rules when that date is set by HM Treasury.

FCA ENFORCEMENT ACTIONS AGAINST FORMER TRADERS FOR LIBOR-RELATED MISCONDUCT

Final Notice to Neil Danziger, former RBS trader

On 8 January 2018, the FCA issued a final notice to Neil Danziger, former trader at RBS. Mr Danziger traded derivative products linked to JPY LIBOR at RBS and, occasionally, acted as the substitute submitter making JPY LIBOR submissions to the British Bankers Association. The final notice issued by the FCA relates to various breaches committed by Mr Danziger in the period between 2007 and 2010.

More specifically, the FCA found that Mr Danziger:

- routinely made requests to RBS's Primary Submitters, in order to influence RBS's LIBOR submissions and benefit from the trading positions for which he and other traders were responsible;
- took his own trading positions and those of other derivatives traders into account when acting as a substitute submitter and when making JPY LIBOR submissions;
- on two occasions, obtained a broker's assistance in an attempt to manipulate the JPY LIBOR submissions of other banks; and
- entered into 28 wash trades (self-cancelling trades with no commercial rationale) in order to generate brokerage payments to two firms as a means of paying them back for personal hospitality laid on for traders.

According to the FCA, these actions contravened Principle 5 of the FCA's Principles for Business by RBS in relation to LIBOR, while the FCA considered the wash trades as further evidence of Mr Danziger's lack of integrity. The FCA decided to ban Mr Danziger from performing any function related to any regulated activity carried on by any authorised person, exempt person or exempt professional firm and imposing a financial penalty of £250,000.

Mark Steward, FCA director of enforcement and market oversight, in the relevant FCA press release, was quoted stating that "market participants cannot turn a blind eye to what the community, through its laws and regulations, expects, nor apply their own, lower standards. This substantial fine and ban should reinforce that message".

Decision Notice to Tom Hayes, a former UBS and Citigroup trader

On 8 November 2017, the FCA published their decision to prohibit Tom Hayes, former UBS and Citigroup yen derivatives trader, from performing any function in relation to any regulated activity in the financial services industry. The FCA took the view that Mr Hayes is not a fit and proper person as a result of his conviction for conspiracy to defraud in relation to the manipulation of JPY LIBOR.

The FCA's decision followed Mr Hayes' former conviction in relation to LIBOR manipulation. In August 2015, Mr Hayes was found guilty of conspiring to manipulate the London Interbank Offered Rate (**LIBOR**) and sentenced to 14 years' imprisonment. His sentence was later reduced to 11 years by the Court of Appeal.

Mr Hayes has referred the FCA's decision to the Upper Tribunal and, consequently, the decision has not yet taken effect.

PRIIPS – UK REGULATIONS PUBLISHED

On 5 December 2017, the UK published its Packaged Retail and Insurance-based Investment Products (**PRIIPs**) Regulations 2017 (**UK Implementing Regulations**), the UK implementing legislation for the EU Regulation on key information documents for PRIIPs (**PRIIPs Regulation**). The regulations came into force on 1 January 2018 along with the PRIIPs Regulation.

The PRIIPs Regulation imposes requirements on manufacturers of PRIIPs to prepare a key information document (**KID**) containing prescribed information on the nature, risks, costs, potential gains and losses of the product. This must be provided to retail investors as a pre-contractual, non-marketing document before the point of sale by those advising on or selling such products. The prescribed information includes, among other things, the name of the PRIIP, identity and contact details of the manufacturer, a description of the intended target audience, as well as a broader description of the risks and features of the product. The definition of PRIIPs is broad, includes most financial instruments other than shares and consequently, has wide ranging implications for many financial services firms.

As the PRIIPS Regulation is directly applicable in the UK, the UK Implementing Regulations do not transpose or alter its text, rather they focus on the process by which the FCA will enforce the requirements contained in the EU level regulation. The UK Implementing Regulations acknowledge the FCA as the competent authority for PRIIPs, give the FCA the power to prohibit or suspend the marketing of a PRIIP or prohibit the provision of a KID and allow the FCA to impose penalties and make statements in relation to contravening PRIIPs.

HM Treasury has committed to reviewing the operation and effect of the UK Implementing Regulation by 1 January 2023 and every 5 years thereafter.

FCA PUBLISHED A MISSION STATEMENT IN RELATION TO CONSUMERS

On 6 November 2017, the FCA published a Consultation Document entitled "FCA Mission: Our Future Approach to Consumers" (**Consultation Document**). The Consultation Documents follows the earlier publication of the FCA's Mission document in April 2017 (**Mission Document**), which explored topics including enforcement, competition, supervision, value for money and authorisation.

In the Consultation Document, which is the first in a series of consultative publications announced in the Mission Document, the FCA sets out how it interprets and intends to fulfil its objectives in relation to consumer protection in financial services. In developing this approach, the FCA has drawn on responses to the Mission Document and the findings of its Financial Lives Survey 2017.

The FCA sets out its vision of a well-functioning market from the perspective of retail consumers and lays out its approach to achieving that vision. The FCA will focus on the needs of all types of retail consumers, but notes that it has limited resources and will have to take "difficult decisions" in order to prioritise its work. The FCA explains that its approach for regulating retail consumer business will be built around the following core areas:

- **Consumer and firm responsibility:** According to behavioural research, consumers do not meet the economically rational "super consumer" standard assumed by research models. Although consumers should still take reasonable responsibility for their choices, firms are expected to frame their "choice architecture" based on real world consumer behaviours and not to exploit biases;
- **Keeping pace with a changing environment:** The FCA recognises that the technological advances, changes in the wider macro-economy and broader environmental changes are affecting the state of play for both firms and consumers. The regulator also acknowledges the need to take into account the "differing characteristics of today's consumers" but at the same time to provide "as much certainty as possible to market participants";
- **Regulating for vulnerable consumers:** "Any consumer can become vulnerable at any time in their life" and become therefore less able to represent their own interests. The FCA expects firms to monitor the possible indicators of vulnerability and have policies in place to deal with vulnerable customers;
- **Having regard to access and tackling exclusion:** Some consumers may find themselves excluded from some financial services due to their particular circumstances, characteristics or firms' perceptions of the potential risks they pose. The FCA promised to develop strategies to address access problems but highlighted the role of the Government and the Parliament in imposing any additional economic obligations on firms in relation to delivering access;
- **Delivering better outcomes for all consumers:** The FCA stated that it will use both prescriptive and less formal tools available to it in order to protect the interests of different groups of consumers. The FCA also noted that it will take the toughest enforcement action available to tackle exploitation of vulnerable or excluded consumers; and
- **Duty of care:** A number of stakeholders suggested the introduction of a new duty of care for firms, imposing an obligation to "exercise reasonable skill and care in the provision of services to consumers". The FCA stated that a thorough and detailed consideration of the issue will be required before any decisions are taken. To that end, it will issue a Discussion Paper on this topic as part of the broader review of the FCA Handbook following the UK's withdrawal from the EU.

The consultation closed on 5 February 2018 and the FCA expects to publish its final Approach to Consumers in summer 2018.

FCA SPEECH ON REGULATORY PRIORITIES FOR RETAIL BANKING

The FCA published a speech delivered by Karina McTeague, the FCA Director of Retail Banking Supervision, on 16 November 2017 regarding the FCA's regulatory priorities for retail banking. The speech particularly focussed on the FCA's strategic review into retail banking business models (**Strategic Review**) and the transposition of the second Payment Services Directive (**PSD2**) in the UK.

Strategic Review

Ms McTeague used the speech to provide further detail on the Strategic Review, following the FCA publication of its purpose and scope paper in October. She stated that the initial discovery phase is underway, which the FCA hopes will allow it to better understand how competitive advantage in retail banking is created and maintained and consider any potential conflict of interest issues in current retail banking business models. The FCA expects to share its phase one findings in mid-2018. Following phase one, the FCA will begin the second phase of

the Strategic Review, which will focus on scenario analysis, particularly looking at the effect of a range of scenarios on retail banking business models and profitability.

PSD2 and the Open Banking Initiative

Ms McTeague identified a combination of PSD2 and the Competition and Market Authority's Open Banking Initiative (**Open Banking Initiative**) as key drivers facilitating a potential "paradigm shift" in the retail banking space.

Ms McTeague cautioned against expectations of a "big bang" following implementation of PSD2 in 13 January 2017, describing the legislation as an "enabler" and "facilitator for greater consumer protection and greater competition".

FCA Approach

Ms McTeague stated that although some of the technical standards underpinning PSD2, including those relating to safety and security requirements, are not expected until mid-2019, the FCA will still expect firms to have policies and procedures in place to monitor, identify and prevent fraud and keep their customers' data safe and secure. Ms McTeague stated that the FCA would be reviewing fraud reports submitted by firms to determine their detection and prevention capabilities in this area.

Ms McTeague stated that the FCA was responding to the potential changes in the industry by bolstering its payments capacity and capability and extending its programme of proactive engagement with existing payment services institutions, as well as preparing to supervise newly regulated firms. The FCA will focus on ensuring:

- firms' culture prioritises treating customers fairly;
- firms have sound systems and controls for effectively managing financial risks; and
- firms have sound systems and controls for combatting financial crime and money laundering risks.

FCA POLICY STATEMENT ON THE PUBLICATION OF INFORMATION ABOUT CURRENT ACCOUNT SERVICES

On 12 December 2017, the FCA set out its policy statement concerning the publication of information about current account services (PS17/26), summarising its conclusions from feedback received from its earlier consultation paper (CP17/24) on the subject.

The new rules require certain personal current account (**PCA**) and business current account (**BCA**) providers to publish prescribed information on their websites. This information includes:

- the provider's account opening process;
- the time taken to replace lost, stolen or stopped debit cards;
- the time taken to organise third-party access to a PCA under power of attorney;
- how and when various services can be accessed and whether 24 hour help is available;
- major operational and security incidents that firms have reported to the FCA;
- service metrics (e.g. the percentage of customers provided with the service on the same day); and
- standing data (information about the way in which and the times at which customers can carry out everyday banking services).

In making this information available, the FCA hopes to make it easier for customers to make informed comparisons and choose the current account provider which best suits their needs. The FCA believes this will ultimately help promote effective competition by enabling customers and intermediaries to make meaningful comparisons between providers of PCAs and BCAs based on quality of service, thereby incentivising providers to improve service and performance.

The regulator expects that the effectiveness of these measures will be "significantly increased" by continuing financial capability initiatives and regulatory developments such as the UK's Open Banking Initiative and the Directive on payment services in the internal market (2015/2366).

The consequent amendments to the Banking: Conduct of Business sourcebook are due to enter into force on 1 April 2018, with publication of additional service metrics expected in August 2018 in order to coincide with the first publication of the core Competition and Markets Authority's service quality indicators.

FOUR INDIVIDUALS CONVICTED IN RELATION TO UNAUTHORISED INVESTMENT SCHEME

The FCA announced on 1 December 2017, that, in a criminal prosecution, Samrat Bhandari and Dr Muhammad Aleem Mirza were found guilty of various offences in relation to the operation of an unauthorised investment scheme. At an earlier hearing, two further defendants, brothers Michael and Paul Moore, pleaded guilty to charges in relation to the same scheme.

Three of the five defendants were given sentences from 9 – 15 months' imprisonment and disqualified from holding the position of director for eight years in the case of Dr Mirza and 10 years in the cases of Michael and Paul Moore. At a later hearing,

Mr Bhandari was sentenced at Southwark Crown Court to a total of three and a half years' imprisonment and disqualified from holding the position of director for 12 years. One of the defendants, Albene Mendy, was found not guilty.

Between 2009 and 2014, the four convicted individuals mis-sold shares in Symbiosis Healthcare Plc (**Symbiosis**) to investors, mostly vulnerable and retired individuals. The investors were promised large profits from the operation of Symbiosis, a company set up to provide "healthcare solutions" and from the development of a network of medical clinics in places like Dubai. However, the shares were effectively worthless. All four defendants played a role in creating a false impression about the prospects of the company and misled investors in a number of ways, including "directly, on the phone, in correspondence, and in person, at Annual General Meetings, as well as through creating and publishing written statements and promotional material by or on behalf of Symbiosis". The value of investments collected was around £1.4 million.

Following the case, Mark Steward, FCA director of enforcement and market oversight, commented that "[m]isleading financial promotions relating to investment schemes cause untold harm to consumers". Mr Steward said that the FCA was determined to hold the individuals involved in operating unauthorised schemes "to account to the fullest extent permitted by law" and that confiscation proceedings will begin in due course.

FCA ISSUES FINAL NOTICE FOR FAILURE TO DISCLOSE INSIDE INFORMATION UNDER MAR

On 13 December 2017, the FCA issued a final notice imposing a £70,000 fine on Tejoori Limited (**Tejoori**) for breaching article 17(1) of the Market Abuse Regulation (596/2014) (**MAR**). This is the first time that the FCA has fined an AIM-listed company for late disclosure following the introduction of MAR on 3 July 2016.

Under article 17(1) MAR, issuers of financial instruments are required to inform the public as soon as possible about inside information which directly concerns them. In this instance, Tejoori held a 10.1% shareholding in BEKON Holding AG (**BEKON**). When BEKON was subject to a takeover bid by Eggersmann Gruppe GmbH, Tejoori failed to disclose an indication from several of its shareholders that they would trigger a drag-along clause requiring Tejoori to sell its shares for no initial consideration, but with the possibility of receiving deferred consideration going forward. This resulted in Tejoori receiving a sum which was substantially less than the valuation of its investment.

Following the transaction Tejoori's share price rose 38% upon speculation that receipt of the consideration was a positive development for the company. The company's nominated advisor was not initially aware of the deferred consideration arrangement and when this was announced to the market, over a month after Tejoori's board became aware of the arrangement, Tejoori's share price closed down 13%.

The FCA considered that knowledge of the forced sale was inside information and that Tejoori had not disclosed it in a timely manner as required under article 17 of MAR and the obligation to disclose price sensitive information under the AIM Rules.

CENTRAL SECURITIES DEPOSITORIES REGULATIONS PUBLISHED

On 28 November 2017, the Central Securities Depositories Regulations 2017 (**Regulations**) came into force. A corresponding explanatory memorandum was also published alongside them.

The Regulations implemented part of the EU Regulation on improving securities settlement and regulating central securities depositories (**CSDs**) (909/2014) (**CSDR**). The implementation of the CSDR will be completed through the introduction of a further statutory instrument amending the Uncertificated Securities Regulations 2001.

In particular, the Regulations:

- provide additional competent authority designation of the Bank of England (**BoE**) and the FCA in relation to the CSDR and grant them additional enforcement powers;
- create a new type of recognised body governed by Part 18 of the Financial Services and Markets Act 2000, the recognised central securities depositories (**RCSDs**);
- put in place procedures in connection with the acquisition of control over RCSDs;
- require institutions to have appropriate procedures in place for the reporting of infringements;
- disapply domestic overlapping provisions; and
- give power to the BoE to make rules codifying the requirement for the central counterparties to notify them of a cyber-incident.

Please contact michael.mckee@dlapiper.com for further information.

USA

SEC ENFORCEMENT ORDER AND GUIDELINES ON ICOS

The US Securities and Exchange Commission (**SEC**) has issued an enforcement order regarding Munchee's 2017 token offering, and SEC Chairman Jay Clayton has released a general public statement on cryptocurrencies and Initial Coin Offerings (**ICOs**).

Following SEC's report on the "DAO", a crowdsourced venture capital platform created by Slock.it and based on the Ethereum blockchain, much of this might not be a surprise – although SEC staff did answer the call of discussing so-called "utility tokens". For further information on SEC's report on the DAO, please refer to our alert.

The SEC action against Munchee is notable because Munchee had at least some argument that its tokens had utility. The concept of the Munchee app is crowd-sourced restaurant reviews, and the app was built before the token offering. The Munchee tokens (**MUN**) were designed to function as an internal currency for "use in the Munchee app for rewards and interactions". Munchee also issued a white paper, replete with disclaimers and carefully avoiding terms such as "ICO" and "investors" and its management and advisory team also had relevant technical and industry experience.

For those of us working in this space, the fact pattern is familiar – and did not feel like the edge cases that had previously caught the ire of the SEC, such as the massive loss of investor capital or a recidivist promising 1,354 % profit in less than 29 days.

So what takeaways can other potential token issuers glean from the Munchee order? How much "utility" is needed?

Almost every token issuer wants its tokens to be "utility tokens," and not "security tokens." For those new to this space, do not be confused by the industry parlance, which was created just a few months ago and has taken off like wildfire. Fundamentally, **the concept is that a token with "utility" should carry an expectation of use, not an expectation of profits**, under the *Howey* test for investment contracts. For further information please refer to our alert discussing the elements of this test.

Here are some guidelines to consider when evaluating your token's claims of utility:

1. **What if my app is already built?** The Munchee order acknowledges that Munchee had "created an iPhone application (**app**) for people to review restaurant meals". Many issuers want to argue they are selling a "minimally viable product" that has immediate utility in the hands of the holder. The SEC clearly regarded the app alone as inadequate and decided to highlight this fact at the very beginning of the order summary. The SEC order emphasised that the app was subject to improvement, that the ecosystem and its participants (advertisers, reviewers, restaurants) did not exist, and that MUN could not buy any goods or services. At a minimum, the SEC is signaling that an adequately advanced version of the app is needed with meaningful use for the token at the time of the offering.
2. **What if I give my tokens "more" utility at issuance?** The SEC was clearly not enamored of Munchee's "utility token" argument. Paragraph 35 was logically unnecessary to the SEC's conclusion. The SEC stated: "Even if MUN tokens had a practical use at the time of the offering, it would not preclude the token from being a security". Even more notably, the SEC broadly characterised the US Supreme Court ruling in *Forman* for the proposition that "purchases of 'stock' *solely* for purpose of obtaining housing" is not the purchase of an "investment contract" (emphasis added). This suggests that **if there is an expectation of profits**, even if that is secondary to the more predominant expectation of use, then a token may be a security. While we may debate this, or hope that the SEC did not really mean this in a paragraph that is technically unnecessary to the order, it is difficult to ignore – especially given that the SEC said basically the same thing in the DAO report.
3. **What if my "*Howey* test score" shows my token has a low risk of being a security?** One of the more particular things we have seen around the ICO space has been the creation of a very thoughtful spreadsheet attempting to reduce the analysis of whether a token is a security to a series of yes/no questions where answers are ascribed values that are summed into likelihood of being a security. Many companies populate this spreadsheet as part of their internet research about ICOs, before calling counsel. While as securities lawyers we appreciate that this device has focused attention on a key issue, there is an obvious garbage-in-garbage-out problem. The SEC chose to mention that Munchee had conducted this exercise and stated that the sale of its tokens "does not pose a significant risk of implicating the federal securities laws" – which is obviously inconsistent with the SEC

order. This seems like apt caution for the hundreds of token issuers who have reached the same self-serving conclusion.

4. **Can I sell my tokens to crypto-investors?** As the Munchee order illustrates, the SEC may regard selling to crypto-investors as indicia of selling securities. If you are selling a prepaid use right, then why not sell this right to the end user? The SEC noted that Munchee did not market or sell to current users of the Munchee app, in restaurant industry media or to restaurant owners. Selling large amounts of products or services to identifiable investors is not how people typically sell software seat licenses, concert tickets, prepaid products or other non-security assets.
5. **Should I build in deal features that cause price appreciation?** The SEC profiled several features of Munchee's token model that may cause token value appreciation – from creating a tiered membership plan that increases reviewer payouts based on the amount of tokens they hold (which constrains supply), to "burning" tokens in certain situations (which reduces supply), to promising to support trading on secondary markets (which allows capturing appreciation and may reduce any illiquidity discount), to supporting liquidity by buying and selling token from its own holdings (which promotes liquidity). These types of features make a token feel like an investment vehicle, not a use right.
6. **Lots of non-security assets increase in value – from homes to baseball cards. Can I discuss this in my token sales materials?** This is the sort of language that causes purchasers to expect profits. The SEC cites lots of examples of this from Munchee in ordering them to cease sales of tokens – from simply stating MUN would rise in value, to its description of deal features designed to achieve this outcome, to endorsing statements of third parties recounting significant gains, to comparisons of MUN to prior ICOs and digital assets that created profits. People do not sell non-investment assets with extensive allusions to increased asset value.
7. **Should I keep it out of my white paper and just discuss token appreciation on Telegram?** There is no real difference. The SEC almost showed off how much social media and non-offering document review it conducted. The Munchee order cites a wide variety of disclosure outlets – from websites, to promotional videos, to articles, to blog posts, to podcasts, to Tweets, to Facebook posts. In addition to the direct marketing efforts of the Munchee team, the SEC highlighted Munchee's endorsement of other people's public touting of the opportunity to profit and the more than 300 people promoting the MUN offering through social media (including translating MUN offering documents into multiple languages for countries in which the app was unavailable).

There are many other interesting aspects of the Munchee order and the public statement from Chairman Clayton, such as:

- The SEC plainly characterised the exchange of bitcoin or Ether for MUN as an investment of money.
- The SEC did not meaningfully discuss the "common enterprise" element of the *Howey* test (an element that many practitioners have emphasised in great detail).
- SEC Chairman Jay Clayton provided the following entertaining example of what may and may not constitute a utility:

> *For example, a token that represents a participation interest in a book-of-the-month club may not implicate our securities laws, and may well be an efficient way for the club's operators to fund the future acquisition of books and facilitate the distribution of those books to token holders. In contrast, many token offerings appear to have gone beyond this construct and are more analogous to interests in a yet-to-be-built publishing house with the authors, books and distribution networks all to come. It is especially troubling when the promoters of these offerings emphasize the secondary market trading potential of these tokens. Prospective purchasers are being sold on the potential for tokens to increase in value – with the ability to lock in those increases by reselling the tokens on a secondary market – or to otherwise profit from the tokens based on the efforts of others. These are key hallmarks of a security and a securities offering.*

If you are considering a token offering, talk to your securities counsel about whether your tokens are securities and how to sell them compliantly. If you have already sold tokens hoping they were utilities, or have received an inquiry from the SEC, talk to your securities counsel. Note that Munchee entered into a settled order that did not name any of its officers or directors and avoided a civil

penalty – in part, because Munchee immediately shut down token sales, returned investor funds and cooperated with the SEC staff.

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FED BOARD INVITES COMMENT ON PROPOSED RISK MANAGEMENT GUIDANCE FOR LARGE FINANCIAL INSTITUTIONS

The Federal Reserve Board of Governors (**Board**) on 4 January 2018 requested public comment on the proposed supervisory guidance regarding effective senior management, the management of business lines and independent risk management, and controls for financial institutions with at least $50 billion in consolidated assets. The proposed guidance would apply to bank holding companies, savings and loan holding companies, foreign banks operating in the US, and non-bank financial companies designated by the Financial Stability Oversight Council for supervision by the Board. It identifies core principles for effective senior management, those who are directly accountable to the firm's board of directors for the day-to-day management of the firm, including ensuring that the firm manages its risk in a way that is prudent and consistent with its business strategy and risk-management capabilities. The proposal also identifies core principles for a firm's management of specific business lines, such as residential mortgage operations, and independent risk management, including ongoing objective and critical assessments of a firm's risks – conducted independently from the firm's business line managers.

This latest proposed guidance is part of a broader initiative to develop a new rating system for large financial institutions (**LFIs**) as part of the post-2008 financial crisis supervisory program. In the 36-page document outlining the proposed guidance, the Fed notes that, in the aftermath of the crisis, it re-evaluated its approach to the supervision of LFIs. In a series of actions since then, the Fed has moved to improve supervisory oversight of systemically important firms that pose the greatest risk to US financial stability, focusing on four key areas: capital planning and positions; liquidity risk management and positions; governance and controls; and resolution planning. Last August, the Fed Board invited comment on a proposed rating system for LFIs and also issued a proposal identifying attributes of effective boards of directors.

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BIPARTISAN BANKING REGULATORY RELIEF BILL ADVANCING IN SENATE

As the second session of the 115th Congress gets under way, momentum is building in the Senate for bipartisan legislation to overhaul the nation's banking regulatory system for the first time since passage of the Dodd-Frank Act in 2010. The Senate Banking Committee on 5 December 2017 advanced the bipartisan Economic Growth, Regulatory Relief and Consumer Protection Act, S. 2155, to the full Senate. The legislation would modernise regulations to benefit smaller financial institutions, such as credit unions, community banks, midsize banks, smaller regional banks and custody banks, while enhancing consumer protections for veterans, senior citizens and victims of fraud.

One of the key provisions of the bill would change the designation of Systemically Important Financial Institutions with assets of $250 billion or less, from the current $50 billion threshold under Dodd-Frank, which is regarded as arbitrary by many in the banking sector. Bank holding companies with between $50 and $100 billion in assets would be immediately exempt from enhanced prudential standards, while those with between $100 and $250 billion in assets would be exempt 18 months after the date of enactment. Under the rubric of improving consumer access to mortgage credit, the legislation would remove the three-day wait period required for mortgage disclosure if a creditor extends to a consumer a second offer of credit with a lower annual percentage rate. Mortgage loans by an insured depository institution or credit union with less than $10 billion in total consolidated assets will be deemed qualified mortgages under the Truth in Lending Act. The Consumer Financial Protection Bureau is instructed to provide "clearer, authoritative guidance" on certain

mortgage-related issues. Provisions to simplify consumers' ability to open bank accounts online are also included in the measure.

The Senate bill is less sweeping than the Financial Choice Act, passed by the House of Representatives in June, which would repeal major provisions of Dodd-Frank. That measure, which passed the House on a near-party-line vote, has not gained traction in the Senate, where some degree of bipartisan buy-in is necessary to move legislation.

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PROPOSALS TO AMEND THE FEDERAL RESERVE ACT

Seven legislative proposals to amend the Federal Reserve Act with regard to the operations of the Fed's Board of Governors and its other bodies were discussed at a 10 January 2017 hearing of the House Financial Services Committee's Subcommittee on Monetary Policy and Trade. The panel heard testimony from experts at policy think tanks, including the right-leaning Heritage Foundation and R Street Institute and the libertarian Cato Institute, whose witnesses generally expressed support for the legislation as a means of enhancing accountability and expanding checks and balances on the Fed. The subcommittee also heard testimony from the left-leaning Center for Economic and Policy Research, which supported some of the transparency measures but expressed concern that other proposals could put more control of the Fed in the hands of the banking industry.

Wednesday's session was a hearing and not a markup, so the subcommittee did not advance the still unnumbered and not yet introduced bills through the legislative process. However, it did serve to highlight reforms being contemplated on Capitol Hill to improve transparency and accountability at the US central bank. Representative Andy Barr (R-KY), the subcommittee chairman, said the measures are intended to "improve the rules-of-the-game for both our monetary policy makers and Congressional overseers. These reforms provide for a monetary policy that is better informed about economic conditions throughout our country, while focusing the Federal Reserve on what it alone can do".

One of the draft bills would specify that the Federal Open Market Committee, rather than the Board of Governors, would be officially responsible for setting the interest rate paid on banks' excess reserve balances. Among the other proposals under discussion is a bill that would bring the non-monetary policy functions of the Fed System into the annual Congressional appropriations process. Another proposal defines blackout periods for communications from the Fed around Federal Open Market Committee meetings as one week before and a day after relevant meetings. Class A Directors' ability to vote for district bank presidents would be restored, reversing a provision of the Dodd-Frank law. Another measure would allow all district bank presidents to vote at every meeting.

The Subcommittee and witnesses also discussed legislation to require salary information and financial disclosures for Fed officials whose salaries exceed those of GS-15 federal employees. Finally, the Subcommittee is considering a proposal to require additional reporting requirements beyond the current semi-annual testimony to Congress.

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SENATORS FOCUS ON ANTI-MONEY LAUNDERING REFORMS

The Senate Banking Committee has kicked off its 2018 schedule with two hearings on proposals to reform and strengthen the 1970 Bank Secrecy Act (**BSA**) to combat money laundering, terrorist financing, corruption, weapons proliferation, sanctions evasion and other illicit activities. A potential package of legislative reforms is receiving initial bipartisan support on some key issues, with members of both parties voicing concerns over the need to update the current BSA/Anti-Money Laundering (**AML**) regulatory regime, while bringing it more closely in line with steps taken by regulators in the EU, UK, Hong Kong and Singapore.

The reform proposals under consideration include raising the mandatory reporting thresholds for currency transactions and suspicious activity, requiring the collection of beneficial ownership information for US companies at the time of incorporation, and allowing greater information sharing among financial institutions and the government. Committee members stressed the need to move towards a more targeted, strengthened AML framework so that banks, law enforcement and regulators can focus on specific threats such as the financing of terrorism and sanctions evasions.

At the more recent of the two hearings, on January 17, the committee heard perspectives from two top Trump Administration officials: Sigal Mandelker, Under Secretary for Terrorism and Financial Crimes in the Treasury

Department, and M. Kendall Day, Acting Deputy Assistant Attorney General, Criminal Division, in the Justice Department. Mandelker and Day outlined the cooperative efforts of their agencies to strengthen AML/CFT (combatting the financing of terrorism) enforcement. They highlighted the need for increased vigilance over emerging threats such as the use of anonymous virtual currency payments to conduct illegal transactions, as well as ever more sophisticated trade-based money laundering schemes, the pervasive use of front companies, the misuse of banks and money services businesses, and obscured beneficial ownership.

At the earlier hearing on 9 January 2018, expert testimony was presented by Dennis Lormel, President and CEO of DML Associates, a financial consultancy (and former Chief of the FBI's Financial Crimes Program); Greg Baer, President of the Clearing House Association, a banking trade organisation; and Heather Lowe, of Global Financial Integrity, a think tank. That hearing included discussion on how compliance with current AML/CFT requirements has become a regulatory burden for financial institutions and is geared toward compliance expectations that often fail to address the main goal of detecting and preventing financial crime.

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BANK REGULATORY NEWS AND TRENDS

We have provided a summary of other key regulatory news and updates in the US banking and financial services space below.

The Powell Era at the Fed begins

On 23 January 2018, with a resoundingly bipartisan 84-13 vote, the Senate confirmed Jerome Powell as the next chairman of the Federal Reserve. Powell, a member of the Fed's Board of Governors since 2012, has worked closely with his predecessor Janet Yellen and won praise from Senate Democrats for his role in implementing reforms under Dodd-Frank as well as his work on stress tests, capital standards and resolution planning. At his confirmation hearing, Powell expressed support for continuity in terms of gradual interest rate increases. He also called for "tailoring" regulations to relieve the burdens on smaller banks and said the Volcker Rule should be tougher for bigger banks but less so for institutions falling below a threshold of $10 billion in assets.

Mulvaney: CFPB to end "regulation by enforcement."

In a 23 January 2018 mission statement to all Consumer Financial Protection Bureau (**CFPB**) staff, acting director Mick Mulvaney signalled his intention to make a sharp break from the practices and policies under previous director Richard Cordray. Mulvaney characterised his predecessor's approach as "pushing the envelope" with the attitude that the CFPB were the "good guys" and the "new sheriff in town, out to fight the bad guys". He promised a comprehensive review of the bureau's investigatory and litigation practices, an enforcement approach based on "quantifiable and unavoidable harm to the consumer" and a regulatory regime with "more formal rulemaking on which financial institutions can rely, and less regulation by enforcement". He also stated that the CFPB would prioritise areas where consumer complaints are more common, shifting focus to areas like debt collection and away from payday lending.

Appeals court upholds CFPB director's independence

On 31 January 2018, the full panel of the US Court of Appeals for the DC Circuit ruled that language in Dodd-Frank that established the CFPB's single-director leadership structure and restrictions on removal from office is constitutional and does not violate the President's authority to appoint and remove executive branch officers. The 7-3 decision – overturning a 2016 ruling by three of the court's judges – means that the President can only fire a CFPB director for cause, and not at will, as per the earlier ruling.

Bipartisan banking regulatory reform legislation gets a boost from Steve Mnuchin

The Treasury Secretary testified before the Senate Banking Committee on 30 January 2018 in support of the Economic Growth, Regulatory Relief, and Consumer Protection Act, which he said "better aligns our financial system to support economic growth in our communities", while reflecting many of Treasury's own recommendations. As noted by DLA previously, the legislation is among items competing for the Senate's attention in an election year with a crowded

legislative agenda. Mnuchin has urged the Senate and the House (which has passed a more sweeping measure repealing major provisions of Dodd-Frank without bipartisan support) to work together to get financial regulatory reform passed soon.

Living will legislation advances

On 30 January 2018 the House of Representatives unanimously approved the Financial Institution Living Will Improvement Act (HR 4292). The bill amends Dodd-Frank to require bank holding companies to submit resolution plans to the Federal Reserve Board and the FDIC every two years, instead of annually. It also requires the Fed and FDIC to provide feedback within six months and to publicly disclose the assessment framework used to review the adequacy of resolution plans.

Office of the Comptroller of the Currency identifies key risks for the federal banking system

The Office of the Comptroller of the Currency (**OCC**) cited credit, operational and compliance risks as key concerns for the federal banking system in its Semiannual Risk Perspective for Fall 2017, which was issued on 18 January 2018. The report warns of consequences to the economy and the credit environment from aggressive competition, tighter spreads, and slowing loan growth. Banks face operational challenges from cybersecurity and other emerging threats, while elevated and increasingly complex compliance obligations will test banks' ability to manage money laundering and other risks, the report found.

OCC for easing Volcker Rule?

According to a recently published report, the OCC is circulating a draft blueprint among financial regulatory agencies to revise the Volcker Rule. Said to be the work of Keith Noreika, acting chair of the OCC for around seven months last year, the draft plan seeks to accommodate the Treasury Department's call for exempting small banks completely and giving all lenders more flexibility to buy and sell assets without violating the rule's ban on proprietary trading. Outright repeal of the rule, a Dodd-Frank requirement, would require Congressional action.

FDIC nominee open to issuing more ILC charters

On 23 January 2018, Jelena McWilliams, President Donald Trump's nominee for chairperson of the Federal Deposit Insurance Corp., told members of the Senate Banking Committee during her confirmation hearing that she will work to end the Federal Deposit Insurance Corporation's (**FDIC**) unofficial moratorium on Industrial Loan Company (**ILC**) licenses. Issuance of ILC licenses was restricted by Dodd-Frank, and though that restriction expired in 2013 the FDIC has not yet issued one. FinTech, retail and other non-banking sector firms are pursuing these licenses as an opportunity to move into deposit-taking, while community banks have long warned of the risks of mixing banking and commerce. McWilliams said she believed such licenses did not pose a threat to the safety of the banking system and added that "If it meets the ILC standards as currently set up by the FDIC, I believe there should be no obstacles in the application program".

Fed Board revises FR Y-7, provides guidance on enhanced prudential standards for foreign banks

On 18 January 2018, the Federal Reserve Board of Governors announced the approval of proposed revisions to the Annual Report of Foreign Banking Organizations (**FBOs**), FR Y-7. The revisions are designed to enable FBOs to comply with certification requirements under Regulation YY, which imposes enhanced prudential standards on FBOs that meet certain asset thresholds. In addition, the announcement of the revised FR Y-7 provides guidance on how an FBO may be permitted to comply with Regulation YY. The revisions are effective from 1 March 2018.

Senators call on President to clarify that FSB rules are advisory

Six Republican Senate Banking Committee members, including Chairman Michael Crapo (R-ID), have written to President Trump urging him to "formally clarify" that standards developed by the Switzerland-based Financial Stability Board (**FSB**) are "advisory in nature, and not binding on the United States or U.S. businesses". The senators, in a 18 January 2018 letter, wrote that the "FSB has morphed into a global regulatory body that operates with minimal oversight and without due process under U.S. law" and expressed concern that the Board "has been driving a significant amount of U.S. policymaking regarding financial regulation".

Fed's supervision chief discusses intent to improve effectiveness of post-crisis regulation

Speaking before an American Bar Association conference on 19 January 2018, the Federal Reserve's Vice Chairman for Supervision Randal Quarles recognised that post-crisis regulation has significantly enhanced the stability of the financial system, but said that regulation now needs to be tailored for better efficiency, transparency and simplicity. While Quarles feels the Fed has made progress in tailoring its regulation and supervision of small, medium, and large firms, he called for more tailoring of regulations for larger banks that are not Global Systemically Important Banks (**G-SIBs**).

In particular, he called for gradation of liquidity requirements for large banks that are not G-SIBs, revisiting the advanced approaches thresholds that identify internationally active banks, and simplification of loss absorbing requirements. Quarles was careful to note that "while I am advocating a simplification of large-bank loss-absorbency requirements, I am not advocating an enervation of the regulatory capital regime". Quarles also said that leverage ratio recalibration is one of the Fed's highest priorities, followed by further improving the transparency of the Fed's annual stress test, reducing the regulatory burdens of resolution planning and streamlining the Volcker rule.

Fed Board invites comment on risk management guidance for Large Financial Institutions

On 4 January 2017, the Federal Reserve Board of Governors unveiled proposed supervisory guidance for financial institutions with at least $50 billion in consolidated assets. Providing core principles for senior management, the management of specific business lines and independent risk assessment, it would apply to bank holding companies, savings and loan holding companies, foreign banks operating in the US and non-bank financial companies designated by the Financial Stability Oversight Council for supervision by the Board. This latest proposed guidance is part of a broader Fed initiative to develop a new rating system for large financial institutions (LFIs) under the post-2008 financial crisis supervisory program. Comments on the proposed guidance will be accepted until 15 March 2018.

Will Congress do banking regulatory reform?

Among the items competing for Congressional attention in this election year is the bipartisan Senate legislation to overhaul the nation's banking regulatory system for the first time since passage of Dodd-Frank in 2010. The Banking Committee in December advanced the Economic Growth, Regulatory Relief and Consumer Protection Act to the full Senate. The legislation would modernise regulations to benefit smaller financial institutions, such as credit unions, community banks, midsize banks, smaller regional banks and custody banks, while enhancing consumer protections for veterans, senior citizens and victims of fraud. One of its key provisions would change the designation of Systemically Important Financial Institutions (SIFIs) with assets of $250 billion and less, from the current Dodd-Frank $50 billion threshold. The Senate bill is less sweeping than the Financial Choice Act, passed by the House of Representatives on a near-party-line vote, which would repeal major provisions of Dodd-Frank.

Proposals to amend the Federal Reserve Act

Highlighting reforms being contemplated on Capitol Hill to improve transparency and accountability, seven legislative proposals to overhaul operations at the Fed's Board of Governors and its other bodies were discussed at a 10 January 2017 hearing of a House Financial Services subcommittee. The panel heard testimony from four policy think tanks, with those from the right generally expressing support for the legislation as a means of enhancing accountability at the Fed, while the sole left-leaning witness expressing concern that some of the proposals could put more control of the Fed in the hands of the banking industry. One of the draft bills would make the Federal Open Market Committee officially responsible for setting the interest rate paid on banks' excess reserve balances. Another would bring the non-monetary policy functions of the Fed system into the annual Congressional appropriations process.

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REGULATION OF CRYPTOCURRENCIES IN CANADA

Initial coin offerings (**ICO**), Initial Token Offerings (**ITO**), blockchain and cryptocurrency are becoming part of everyday vernacular and Canadian security regulators, including the Canadian Securities Administrators (**CSA**) (the umbrella organisation comprised of regulators from all Canadian provinces) and the Ontario Securities Commission (**OSC**) are making a concerted effort to make the Canadian securities regulatory landscape "FinTech friendly". With the CSA Regulatory Sandbox, which was launched in 2016, and the OSC LaunchPad, launched on 24 October 2016, regulators are providing FinTech companies with the opportunity to obtain exemptive relief from securities law requirements while adequately protecting Canadian investors. It may be too soon to evaluate the effectiveness of these programs to drive and promote innovation in Canada but regulators recognise that FinTech is a worldwide phenomenon and are focused on achieving an effective regulatory environment. The CSA has partnered with the Australian Securities and Investment Commission and the FCA with a view to fostering FinTech innovation, expanding information sharing and supporting FinTech businesses.

The need for the CSA Regulatory Sandbox arises in many ways from the CSA's clarification that cryptocurrencies or tokens may be designated as "securities" under applicable provincial securities laws. On 24 August 2017, the CSA published CSA Staff Notice 46-307 *Cryptocurrency Offerings* (**CSA Notice**) indicating that the following factors will apply in making this determination: (i) Is money being invested?; (ii) Is the money invested in a "common enterprise"?; (iii) Is there an expectation of profit?; and (iv) Is the profit expectation derived from the undeniably significant efforts of others? The application of these factors will have varying results depending on the cryptocurrency in question, in particular, the currency's adoption rate, stage of development and whether it is centrally administered or is a fully decentralised autonomous organisation (**DAO**).

Businesses trading securities in Canada may be required to register with the CSA as dealers. Whether a FinTech company is dealing (trading in securities for a business purpose) is determined on a case-by-case basis and will depend on various factors, including: (i) Is the cryptocurrency considered a "security"?; (ii) How broadly are investors being solicited?; (iii) Is the business using the internet, including public websites to reach potential investors?; (iv) Does the business actively advertise the sale of the cryptocurrency?; and (v) Is the business raising a considerable amount of capital from a large number of investors? Should it be determined that a FinTech company is dealing in securities, then like any securities dealer, it must meet its obligations to investors under Canadian laws, including know-your-client and suitability requirements, as well as other ongoing registrant obligations.

Similarly, businesses pooling funds to invest in cryptocurrencies that are securities will need to register as investment fund managers and those advising investors in respect of cryptocurrencies that are securities will be required to register as advisers.

To date, two cryptocurrency companies have been granted exemptive relief from CSA's provincial regulatory bodies. Impak Finance Inc. conducted Canada's first initial coin offering and was granted exemptive relief on 15 August 2017 from the dealer registration requirement and prospectus requirements by the Autorité des Marchés Financiers. Token Funder Inc., who conducted Ontario's first regulated initial token offering, was granted exemptive relief from dealer registration requirement and received approval of its application to launch the ITO by way of private placement under the offering memorandum prospectus exemption on 17 October 2017.

Additionally, in conjunction with the CSA Regulatory Sandbox, provincial regulators have granted five registrants the right to manage cryptofunds. The regulators imposed certain cryptocurrency-specific terms and conditions including, but not limited to, regulatory approval of the cryptocurrency they wish to invest in, use of a custodian with specific cryptocurrency expertise and providing the principal regulator with quarterly reports.

It remains to be seen whether the majority of FinTech companies conducting business in Canada are going to capitalise on the CSA Regulatory Sandbox or the OSC LaunchPad initiatives, or if uncertainties surrounding this rapidly evolving regulatory landscape lead to a more cavalier approach to compliance. In this respect, we note that companies which conduct regulator-sanctioned FinTech activities tend to advertise the superiority, from an investor-protection standpoint, of their regulated platform (e.g. https://www.tokenfunder.com/). We expect many will follow this lead.

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INTERNATIONAL

UPDATE ON BASEL III REFORMS

Following the financial crisis, a number of regulatory reforms have been developed by the Basel Committee on Banking Supervision (**BCBS**). The latest developments on the BCBS reforms (also known as "Basel III") are summarised below.

BCBS final guidelines for the identification and management of step-in risk

On 25 October 2017, following consultations in December 2015 and March 2017, the BCBS published its final guidelines for the identification and management of step-in risk.

Step-in risk refers to the risk that, in the event an entity experiences financial stress, a bank provides financial support to that unconsolidated entity where it is not contractually bound to, or extends support beyond the bank's existing contractual obligations. The guidelines are designed to help mitigate potential spillover effects from the shadow banking system to banks.

The guidelines cover the following issues with regard to banks' self-assessment of step-in risk and reporting to supervisors:

- the definition of the scope of entities to be evaluated for potential step-in risk, based on the relationship of these entities with the bank;
- the identification of entities that are immaterial or subject to collective rebuttals and their exclusion from the initial set of entities to be evaluated;
- an assessment of all remaining entities against the step-in risk indicators provided in the guidelines, including potential mitigants;
- an estimation of the potential impact on liquidity and capital positions and a determination of the appropriate internal risk management action for entities where step-in risk is identified; and
- the reporting of the self-assessment of step-in risk to the supervisor.

Under the guidelines, after reviewing the bank's self-assessment analysis, the supervisor has to decide whether any additional supervisory response is required.

The BCBS expects the guidelines to be implemented in member jurisdictions no later than 2020, when the first round of self-assessments and supervisory reviews should be conducted.

BCBS finalises outstanding Basel III reforms

On 7 December 2017, the BCBS announced in a press release that the committee's oversight body had approved the remaining Basel III regulatory reforms (sometimes referred to as "Basel IV").

The reforms include the following:

- a revised standardised approach for credit risk, designed to improve the robustness and risk sensitivity of the existing approach;
- revisions to the internal ratings-based approach for credit risk, where the use of the most advanced internally modelled approaches for low-default portfolios will be limited;
- revisions to the credit valuation adjustment framework, including the removal of the internally modelled approach and the introduction of a revised standardised approach;
- a revised standardised approach for operational risk, which will replace the existing standardised approaches and the advanced measurement approaches;
- revisions to the measurement of the leverage ratio and a leverage ratio buffer for global systemically important banks (**G-SIBs**), which will take the form of a Tier 1 capital buffer set at 50% of a G-SIB's risk-weighted capital buffer; and
- an aggregate output floor, which will ensure that banks' risk-weighted assets (**RWAs**) generated by internal models are no lower than 72.5% of RWAs as calculated by the Basel III framework's standardised approaches, and a requirement to disclose banks' RWAs based on these standardised approaches.

The revised standards will take effect from 1 January 2022 and will be phased in over five years. It was also announced in the press release that the implementation and regulatory reporting date for the BCBS' revised market risk framework has been postponed to 1 January 2022, giving banks additional time to develop their systems and allowing the BCBS to address "certain specific issues related to the market risk framework".

FSB REPORT ON ARTIFICIAL INTELLIGENCE AND MACHINE LEARNING IN FINANCIAL SERVICES

On 1 November 2017, the Financial Stability Board (**FSB**) published a report considering the financial stability implications of artificial intelligence (**AI**) and machine learning in financial services.

The report notes that the increased use of AI is being driven by a number of factors. Supply-side factors include technological advances and the availability of financial sector data and infrastructure, while the demand-side factors include profitability needs, competition with other firms and the demands of financial regulation.

The FSB note that AI and machine learning are currently being applied in financial services:

- to assess credit quality, price and market insurance contracts and automate client interaction;
- to optimise scarce capital, back-test models and analyse the market impact of trading large positions;
- by hedge funds, broker-dealers and other firms to find signals for higher (and uncorrelated) returns and optimise trading execution; and
- by public and private sector institutions for regulatory compliance, surveillance, data quality assessment and fraud detection.

While the primary benefit accruing from this innovation is the likelihood that more efficient processing of information could contribute to a more efficient financial system, the FSB also drew attention to a number of risks arising from the increased use of AI and machine learning. These include:

- the possibility that network effects give rise to third-party dependencies, leading to the emergence of new systemically important players that fall outside existing regulatory parameters;
- the risk that applications of AI and machine learning could result in new and unexpected forms of interconnectedness between financial markets and institutions, increasing the risk of contagion during financial crises;
- the possibility that the lack of interpretability of AI and machine learning and the widespread use of opaque models could become a macro risk as well as the possibility that a widespread use of opaque models results in unintended consequences; and
- the risk that inadequate testing and training of AI tools could exacerbate issues around data privacy, conduct risks and cyber security.

The report followed the FSB's report into the financial stability implications of FinTech that was published in June 2017.

IN FOCUS

PSD2 – A REVOLUTION IN THE PAYMENTS SPACE

The second Payments Services Directive (2015/2366) (**PSD2**) came into force throughout the EU on 13 January 2018. PSD2 strengthens and extends the legal foundation for an EU single market for payment services, covering payment institutions, credit institutions and e-money institutions. It is designed to address the significant technological developments which have occurred in retail payment services since the First Payment Services Directive (2007/64) (**PSD1**) was adopted in 2007.

This article considers the recent developments around PSD2, both at a European and UK level, before providing an overview of its implementation status in key European jurisdictions.

PSD2 – IMPLEMENTATION AT A EUROPEAN LEVEL

Delegated Regulation supplementing the Interchange Fee Regulation with regulatory technical standards on the separation of payment card schemes and processing entities

On 18 January 2018, the Delegated Regulation on interchange fees for card-based payment transactions (2018/72) (**Delegated Regulation**) was published in the Official Journal of the EU (**OJ**).

This legislative instrument contains the regulatory technical standards (**RTS**) on establishing the requirements to be complied with by payment card schemes and processing entities. It supplements the existing Interchange Fee Regulation (2015/751) (**IFR**), which introduced caps on the fees of consumer debit and credit card payments, allowed retailers to choose which card payment options to use and required card schemes to ensure the independence of their own processing activities from the rest of their operations. To ensure such independence, the new RTS rules introduce detailed requirements around the separation of certain functions, including limits on information exchange and separate profit and loss accounts, corporate authorisations and decision making.

The Delegated Regulation will enter into force on 7 February 2018.

Payments Accounts Directive technical standards published

On 11 January 2018, a number of technical standards required under the Payment Accounts Directive (2014/92) (**PAD**) were published in the OJ.

PAD came into force on 17 September 2014, with member states having to transpose most of its provisions into national law by 18 September 2016. Its aim was to improve the transparency and comparability of fee information about payment accounts (including current accounts), help people switch payment accounts, and ensure every EU resident has access to a basic bank account.

The technical standards, which were all adopted by the Commission on 28 September 2017, are summarised below:

- Commission Delegated Regulation (2018/32) – contains RTS outlining standardised terminology for most representative services linked to a payment account (article 3(4) of the PAD);
- Commission Implementing Regulation (2018/33) – contains implementing technical standards (**ITS**) with respect to the standardised presentation format of the statement of fees and its common symbol. This concerns the requirement that payment service providers (**PSPs**) provide the customer with a statement on fees and applicable information regarding interest rates at least annually and free of charge; and
- Commission Implementing Regulation (2018/34) – contains ITS on the standardised presentation format of the fee information document and its common symbol. This relates to the requirement that PSPs provide the customer with a fee information document in a durable medium.

Final EBA guidelines on security measures for operational and security risk under PSD2

On 12 December 2017, the EBA published its final report on guidelines on the security measures for operational and security risks under PSD2.

This provides that PSPs shall establish a framework with appropriate risk mitigation measures and control mechanisms to manage operational and security risks relating to the payment services they provide.

In developing these guidelines, the EBA has considered existing EBA guidelines on the security of internet payments under PSD1 and carried out a risk analysis to determine the main threats and vulnerabilities to which PSPs are exposed.

In total, the EBA sets out 9 guidelines around the security measures for operational and security risk. These include a general requirement for proportionality, as well as guidelines covering governance, risk management and control models, outsourcing, risk assessment, processes and assets, the protection and integrity of data and systems, physical security and access control.

The guidelines also cover the monitoring, detection and reporting of operational or security incidents, business continuity management, scenario-based continuity plans, the testing of security measures, situational awareness and the management of the relationship with payment service users.

The official EU language versions of the guidelines were published on the EBA website on 12 January 2018, meaning they will apply once the NCAs have implemented them into their national and supervisory frameworks.

UK IMPLEMENTATION OF PSD2

PSD2 is being transposed into UK law via the Payment Services Regulations 2017 (**PSRs 2017**), most provisions of which came into force on 13 January 2018 in accordance with the timescales under PSD2. The PSRs 2017 repeal and replace the Payment Services Regulations 2009 (SI 2009/209). A number of workstreams with respect to the implementation of PSD2 are still ongoing in the UK, the most recent of which are outlined below.

PSR open letter to NPSO

On 18 January 2018, the Payment Systems Regulator (**PSR**), published an open letter from its Managing Director Hannah Nixon to the CEO of the New Payment System Operator (**NPSO**), Paul Horlock, setting out the PSR's expectations of the NPSO's initial priorities.

The formation of the NPSO had been announced in September 2017. This organisation will take over the operation of the three key interbank retail payment systems (Bacs, Faster Payments and the new Image Clearing System for cheques).

Ms Nixon notes that the following targets "would need to be met for the NPA to be successful":

- increased innovation in the payments industry;
- effective competition across all layers of the New Payments Architecture (**NPA**);
- delivery of the NPA in a timely manner, with support and engagement from all stakeholders; and
- a NPA which is technically robust and resilient.

The PSR also sets out the following 6 priorities for the NPSO: (i) stakeholder engagement; (ii) strategy setting and decision making; (iii) competitive procurement of the NPA's central infrastructure; (iv) development and management of NPA rules and standards; (v) clarification of the NPSO's "market catalyst" role; and (vi) risk management.

The PSR has asked the NPSO to respond to the priorities set out in the Annex of its letter by no later than 30 March 2018.

FCA statement on EBA guidelines on operational and security risks under PSD2

On 19 December 2017, the FCA published a statement relating to the EBA guidelines on operational and security risks under PSD2 (**Guidelines**). This followed the publication of the EBA's final guidelines on 12 December 2017. Please refer to the text above for further information on the EBA guidelines.

The FCA stipulated that all PSPs are expected to comply with the Guidelines from 13 January 2018 in addition to the requirements set out in regulation 98 (Management of operational and security risks) of the PSRs 2017, the UK's implementing legislation. The FCA noted that this would include firms undertaking account information and payment initiation services.

The FCA committed to consulting on its approach to applying these Guidelines and its expectations on PSPs' future reporting requirements during 2018. The FCA also reminded firms applying or re-applying for authorisation that applications must contain a statement of the applicant's security policy, including a description of the applicant's measures to comply with Regulation 98(1), taking the Guidelines into consideration.

Guidance on new payment surcharge rules for consumer and business transactions

In December 2017, the Department for Business, Energy and Industrial Strategy published its updated guidance on the Consumer Rights (Payment Surcharges) Regulations 2012 (**Regulations**), which supersedes guidance previously published in March 2013 and August 2015.

For most retail payments, the Regulations ban merchants from charging a fee in addition to the advertised price of a transaction on the basis of a consumer's choice of payment instrument. For other retail payments and most payments between businesses made with commercial payment instruments, the Regulations ban merchants from charging customers more than the direct cost borne by them for use of the relevant means of payment.

The Regulations apply to contracts, however concluded, and entitle customers to a refund for any unlawful surcharge which they have paid. In addition, customers may take legal action to recover such surcharges, and consumer enforcement authorities have the power to take civil enforcement action against any traders who breach the Regulations.

PSD2 – Implementation status of member states

For reference, we have included a table setting out the implementation position for PSD2 in our key European jurisdictions. If you require any additional information on those countries listed below please refer to your local DLA Piper contact below.

Country	Status	Description
Denmark	Implemented	Denmark has, since 1 January 2018, implemented PSD2 through the Payments Act (in Danish: lov om betalinger).
Finland	Implemented	Finland has implemented PSD2 into Finnish law in two parts: titles III and IV were implemented by amendments to the Finnish Payment Services Act through Law on Amendments to the Payment Services Act (Fi: Laki maksupalvelulain muuttamisesta, 898/2017) and title II, IV and VI by amendments to the Finnish Payment Institutions Act through Law on Amendments to the Payment Institutions Act (Fi: Laki maksulaitoslain muuttamisesta, 890/2017). Both laws entered into force on 13th January 2018.
France	Implemented	PSD2 entered into force on 13 January 2018, via Ordonnance no 2017-1252 of 9 August 2017 and Décret (Decree) no 2017-1314 of 31 August 2017.
Germany	Implemented	The German implementation law entered into force on 13 January 2018, via the Gesetz zur Umsetzung der Zweiten Zahlungsdiensterichtlinie dated 17 July 2017. Some of the commentary to date has been focused on how payment institutions will meet security requirements, the mechanisms by which Payment Initiation Service Providers (**PISPs**) can authenticate payers and the protection of information provided to Account Information Service Providers and PISPs.
Greece	Not implemented	PSD2 has not yet been implemented in Greece. The relevant draft law was published on 2 November 2017.
Italy	Implemented	Legislative Decree no. 218 of 15 December 2017, which entered into force on 13 January 2018, has implemented the PSD2 in Italy. The focus of this implementing legislation has been on encouraging electronic device initiated payment transactions and promoting competition.
Luxembourg	Not implemented	PSD2 shall be implemented into Luxembourg law by the bill no. 7195 on payment services that was submitted with the Luxembourg Chamber of Deputies on 10 October 2017, but as of 23 January 2018 had not yet been adopted. Furthermore, the Luxembourg Supervision Commission of the Financial Sector has published a Circular CSSF 18/677 concerning the EBA Guidelines on the information to be provided for the authorisation of payment institutions and for the registration of account information service providers under Article 5(5) of Directive (EU) 2015/2366 on payment services in the internal market.
Netherlands	Not implemented	In the Netherlands, the implementation of PSD2 is delayed. It is currently expected that implementation will take place between June and September 2018. This will most likely be via two separate laws that will amend the Dutch Financial Supervision Act (Wet op het financieel toezicht), the Dutch Civil Code (Burgerlijk Wetboek) and ancillary laws. These laws are currently available in their draft form and no final implementation laws are yet available. The laws implementing PSD2 are the Implementing Act PSD2 (Implementatiewet herziene richtlijn betaaldiensten) and Implementing Decree PSD2 (Implementatiebesluit herziene richtlijn betaaldiensten).

Country	Status	Description
Norway	Not implemented	In Norway, PSD2 will be transposed in two parts. Titles III and IV are implemented by amendments to the Norwegian Financial Contract Act of 1999 and titles II, IV and V by changes to the Norwegian Financial Undertakings Act of 2015 and the Payment System Act of 1999. Norway is still in the early stages of the legislative process in implementing PSD2. The draft implementation acts and draft explanatory notes in respect of the institutional rules in titles II, IV and VI were published in May 2017, subject to consultation, and the other consultation paper in respect of titles II and IV on 7 September 2017, with a deadline to comment in the consultation process by mid-December 2017. As of 24 January 2018, we are still waiting for the draft acts to be published based on the consultation process.
Portugal	Not implemented	A public consultation has been published by the Bank of Portugal on the framework for the transposition of PSD2. However, the scope of the consultation was limited to the options that PSD2 allows each Member State to make and did not include other relevant issues raised by PSD2. Furthermore, as of 11 January 2018 there has been no disclosure of draft PSD2 implementing legislation.
Spain	Not implemented	Spain has not implemented PSD2 yet. The Ministry of Economy only recently published a first draft of law implementing PSD2. The public consultation for this closed on 16 January 2018.
Sweden	Not implemented	Sweden is delayed in implementing PSD2, and the new regulation will enter into force at the earliest on 1 May 2018. The proposed amendments to the Payments Services Act (Sw. Lag (2010:751) om betaltjänster) were sent to the Swedish Council on Legislation on 9 November 2017. Swedish FSA regulations are expected to be published when the proposition is adopted.
UK	Implemented	PSD2 was implemented into UK law via the PSRs 2017, most of the provisions of which came into force on 13 January 2018 (see above).

MIFID II – A SECOND OVERHAUL OF EUROPE'S REGULATORY FRAMEWORK

The second Markets in Financial Instruments Directive (2014/65) (**MiFID II**) came into force on 3 January 2018, alongside the Markets in Financial Instruments Regulation (600/2014) (**MiFIR**). Both pieces of legislation set out the framework of requirements for investments firms operating in the EEA and are aimed at achieving more transparency and greater protection for investors.

This article examines some of the key developments which took place in the run-up to the implementation date as well as the ongoing workstreams in relation to MiFID II and MiFIR.

EUROPEAN IMPLEMENTATION OF MIFID II

European Commission FAQs on MiFID II inducements and research reforms

On 26 October 2017, the European Commission (**Commission**) published a set of FAQs on the application of MiFID II to third country broker-dealers in order to assist MiFID II portfolio managers and their third country sub-advisors with implementation of MiFID II in a cross-border context. The FAQs reflect the Commission's position and do not constitute authoritative interpretation of EU legislation but are likely to be followed as it is expected to be some time before any more authoritative interpretation is given.

The FAQs have been published following discussions between the Commission, the US Securities and Exchange Commission (**SEC**) and other non-EU jurisdictions, after UK market participants raised concerns with the FCA that, as MiFID II comes into effect, they would be unable to continue to access research in non-EU jurisdictions and comply with the MiFID II requirements.

Following discussions with the Commission, the SEC has also published a related press release providing information about no-action letters it issued to facilitate the cross-border implementation of the MiFID II research provisions.

The FCA published a statement welcoming the announcements of the Commission and SEC. It explained that the announcements enable arrangements that comply with MiFID II and other jurisdictions' rules, while allowing EU firms' continued access to research produced by US and other non-EU jurisdictions.

MiFID II technical standards published

On 26 October, two sets of technical standards required under MiFID and MiFID II were published in the Official Journal of the EU (**OJ**).

1. Authorisation of investment firms:

Commission Delegated Regulation 2017/1943 contains regulatory technical standards (**RTS**) on information and requirements for the authorisation of investment firms. The RTS, developed under Article 7(4) of MiFID II, contain a harmonised list of information investment firms will have to submit to be authorised. They also set out the requirements applicable to the management of certain investment firms and the requirements imposed on shareholders and members with qualifying holdings.

Commission Implementing Regulation 2017/1945 contains implementing technical standards (**ITS**) with regard to notifications by the applicant firms and communication between the competent authorities and investment firms. The ITS, made under Article 7(5) of MiFID II, contain standard forms, templates and procedures for the notification or provision of information concerning applications for authorisation.

2. Acquisitions of qualifying holdings in investment firms:

Commission Delegated Regulation 2017/1946, made under Article 10a(8) of MiFID and Article 12(8) of MiFID II, contains RTS on an exhaustive list of information to be submitted by proposed acquirers in the notification of a proposed acquisition of a qualifying holding in an investment firm. The proposed acquirer will be required to submit information, including the identity of acquirer and any persons that will effectively direct the business of the target entity, details of the acquisition and its financing and the new proposed group structure and its impact on supervision.

Commission Implementing Regulation 2017/1944 contains ITS concerning the notification of a proposed acquisition of a qualifying holding in investment firms. The ITS were developed by the Commission under Article 10a(8) of MiFID and Article 12(9) of MiFID II. They lay down the standard forms, templates and procedures for the exchange of information between the competent authorities of the target and proposed acquirer.

All of the four Regulations listed above entered into force on 15 November 2017.

European Commission Equivalence Decisions

In December 2018, the Commission published two equivalence decisions to ensure that businesses and markets could continue to operate smoothly and without disruptions after 3 January 2018, when MiFID II and MiFIR became effective.

On 5 December 2017, the European Commission adopted an Implementing Decision on the equivalence of the legal and supervisory frameworks applicable to designated contract markets (**DSMs**) and swap execution facilities (**SEFs**) in the US under Article 28(4) of MiFIR. The legal and supervisory framework of the US applicable to DSMs and SEFs was considered by the Commission to be equivalent to the requirements laid down in MiFIR for trading venues. The Decision was published in the OJ on 6 December 2017 and entered into force on the next day.

The joint statement (**Statement**) issued by the European Commission and the US Commodity Futures Trading Commission (**CFTC**) explains that the US Decision allows EU counterparties to trade derivative instruments that are subject to the trading obligation on CFTC-authorised DCMs and SEFs in the US. This decision does not affect the ability of EU counterparties to continue to trade on any CFTC-authorised SEF or DCM with respect to those derivatives which are not subject to the EU's trading obligation.

On 21 December 2017, the Commission adopted an Implementing Decision on the equivalence of the legal and supervisory framework applicable to stock exchanges in Switzerland (**Swiss Decision**) in accordance with Article 25(4)(a) of MiFID II. The Commission considered the legal and supervisory framework applicable to stock exchanges in Switzerland to be equivalent to the relevant EU requirements. SIX Swiss Exchange AG and BX Swiss AG are now considered equivalent to MiFID II regulated markets. This Decision is of limited duration and will expire on 31 December 2018 unless the Commission extends it prior to that date.

The Commission also explained that Switzerland differs in a number of ways from other jurisdictions that have been granted equivalence. The scope of this decision is much greater because the trading of Swiss shares in the EU (and vice versa) is more widespread than with the other jurisdictions that were recently

recognised. As a result, "trading in Switzerland will have a bigger and more immediate impact on the integrity of EU financial markets, including regarding the prevention of market abuse".

ESMA statement on delaying the implementation of LEIs

On 20 December 2017, ESMA published a statement on the introduction of LEI requirements. The statement postpones the full application of the rules for six months, subject to certain conditions.

Under the rules introduced in MiFID II, EU investment firms will be prohibited from providing certain services to clients until the LEI code for that client has been obtained by the client. Similarly, EU trading venues will have to identify every issuer of financial instruments traded on them with an LEI code. In order to support the smooth introduction of the LEI requirements, ESMA is going to allow investment firms and trading venues to comply with a lighter set of requirements for a period of six months.

Investment firms will be able to provide services to clients without LEIs if they obtain the necessary documents from those clients to apply for an LEI code on their behalf, and the trading venues will be allowed to report their own LEI codes instead of LEI codes of non-EU issuers currently not having their own LEI codes.

To put these temporary arrangements in place, the FCA is required to change a validation rule in its transaction reporting system. In its response to ESMA's statement, the FCA explained that it will make the required amendments as soon as possible, but was not able to do so before 3 January 2018, the date the requirements began to apply.

Delegated Regulation under MiFIR relating to trading obligation for derivatives

On 22 December 2017, Commission Delegated Regulation 2017/2417 supplementing MiFIR with regard to RTS on the trading obligation for certain derivatives was published in the OJ.

Article 28 of MiFIR introduces a trading obligation for derivatives. It requires that derivative contracts which are subject to the trading obligation may only be traded on a regulated market, multilateral trading facility, organised trading facility or third-country trading venue deemed to be equivalent by the Commission. Article 32(1) of MiFIR required ESMA to develop RTS specifying the derivatives that should be subject to the trading obligation and the date or dates from which this trading obligation must take effect.

ESMA submitted the draft RTS to the Commission in September 2017, which adopted the RTS in a Delegated Regulation on 17 November 2017, listing the relevant derivatives in its Annex. Neither the European Parliament or the Council of the EU raised objections to the Delegated Regulation, which entered into force on 23 December 2017.

ESMA consults on systematic internalisers' quote obligations

On 9 November 2017, ESMA published a consultation paper on the proposed amendment of article 10 of Delegated Regulation 2017/587 (**RTS 1**). The consultation paper also addressed some other amendments to RTS 1 to enable a more consistent and unambiguous application of its provisions.

ESMA was required under article 14(7) of MiFIR to draft RTS to specify, with regard to the quoting obligation for SIs, "the determination of whether prices reflect prevailing market conditions". ESMA's draft RTS were endorsed by the European Commission and published in the OJ in March 2017.

ESMA later considered whether SIs' quotes "should under certain circumstances reflect the same minimum price increments as orders and quotes submitted to trading venues trading for the same financial instrument". ESMA took the view that, in order to ensure that SIs' quotes adequately reflect prevailing market conditions, it may be necessary to link them to the minimum tick sizes applicable to trading venues.

The consultation closed on 25 January 2018, and ESMA intends to use the input from stakeholders to finalise the amendments to RTS 1.

UK IMPLEMENTATION OF MIFID II

FCA published position limits for commodity derivative contracts

On 18 October, the FCA published a webpage containing position limits for commodity derivatives. The FCA is required under MiFID II to set limits on the maximum size of positions held by a person together with those held on its behalf at an aggregate group level. The webpage lists some of the commodity derivative contracts which the FCA has identified as trading on a UK trading venue, including the entries for bespoke contracts and de minimis aggregated contracts.

The position limits apply as of 3 January 2018. The FCA notes that these may be revised if it decides it is necessary to do so or as a result of an ESMA Opinion.

FCA "Dear CEO" letter on payment for order flow

On 13 December 2017, the FCA published a "Dear CEO" letter regarding the Payment for Order Flow (**PFOF**), which follows the publication of the FCA Market Watch 51 on PFOF in September 2016.

In the letter, the FCA expressed its view that the practice of brokers demanding "payments from counterparties as a condition for conducting client business with them substantially undermines a broker's ability to act as a good agent". It also

repeated its concerns that PFOF arrangements are (i) bad for markets, (ii) undermine the transparency and efficiency of price formation, (iii) inhibit competition and (iv) lead to poor outcomes for end clients. The regulator further stated that firms continuing to charge PFOF will be in breach of MiFID II standards and highlighted that action had to be taken in order to ensure compliance.

The market intelligence gathered by the FCA suggested that some brokers were designing structures to avoid the rules introduced by MiFID II and provided examples of such structures. The FCA stated that "[t]his will be a priority area of supervisory focus after January" and warned against any attempts to circumvent the requirements. Furthermore, the FCA stated that any market makers offered to enter into arrangements that attempt to avoid complying with the rules should not only decline to do so but also notify the FCA of these attempts.

MiFID II – Implementation status of member states

For reference, we have included a table setting out the implementation position for MiFID II in our key European jurisdictions. If you require any additional information on those countries listed below please refer to your local DLA Piper contact below.

Country	Status	Description
Denmark	Implemented	Denmark has, since 3 January 2018, implemented MiFID II through the Capital Markets Act (in Danish: lov om kapitalmarkeder), the Financial Business Act (in Danish: lov om finansiel virksomhed) and the Financial Advisors Act (in Danish: lov om finansielle rådgivere og boligkreditformidlere).
Finland	Implemented	Finland has implemented MiFID II / MiFIR into Finnish law by amending the Investment Services Act through the Law on amendments of Investment Services Act (Fi: Laki sijoituspalvelulain muuttamisesta, 1069/2017) and by repealing the current Act on Trading in Financial Instruments and enacting a new act by the same name (Act on Trading in Financial Instruments (Fi: Laki kaupankäynnistä rahoitusvälineillä 1070/2017). Both laws entered into force on 3rd January, 2018. In connection with these, many financial market and financial product laws were revised technically to reflect the changes to the above mentioned acts.
France	Implemented	MiFID II has been implemented into French law via (i) Ordonnance no 2016-827 of 23 June 2016 and Ordonnance no 2017-1107 of 22 June 2017 and (ii) Décrets (Decrees) no. 2017-1253 and no. 2017-1324.
Germany	Implemented	Has been implemented in full into German law via the Zweites Gesetz zur Novellierung von Finanzmarktvorschriften auf Grund europäischer Rechtsakte (Zweites Finanzmarktnovellierungsgesetz – 2. FiMaNoG) dated 23 June 2017.
Greece	Not implemented	MiFID II has not yet been implemented in Greece. The relevant draft law was submitted for discussion before the Greek Parliament on 14 December 2017.
Italy	Partially implemented	Implementation is almost completed. The Italian Financial Act (Legislative Decree no. 58 of 1998) has been amended by Legislative Decree no. 129 of 3 August 2017 in order to implement the main provisions of MiFID II. The new provisions are effective as of 3 January 2018. In addition, Consob has launched and completed a series of consultations in relation to the adoption of the MiFID II's level 2 measures such as passporting, conduct rules and investor protection. The final version of those MiFID II's level 2 measures are expected to be enacted and published shortly. Other level 2 measures (such as those concerning market exchanges and trading venues) have already been implemented (e.g. by the adoption of the new Consob Regulation no. 20249 of 28 December 2017 on "Market Exchanges").

Country	Status	Description
Luxembourg	Partially implemented	Bill no. 7157 on markets in financial instruments has been submitted with the Luxembourg Chamber of Deputies on 3 July 2017 in order to implement MiFID II into Luxembourg law, but has not yet been adopted. The Luxembourg Supervision Commission of the Financial Sector noted in its press release 17/47 (on the application of MiFID II/MiFIR in the Grand Duchy of Luxembourg as of 3 January 2018) that irrespective of the fact that the new law has not been passed yet, the MiFIR provisions are binding and directly applicable in Luxembourg from 3 January 2018 by virtue of Article 288 of the Treaty on the Functioning of the European Union (except the provisions of Article 37 of MiFIR which shall apply from 3 January 2020). Furthermore, the more protective provisions of MiFID II which confer new rights or are more favourable than the applicable national rules and regulations shall also apply from 3 January 2018 and existing legal provisions shall be interpreted accordingly.
Netherlands	Implemented	The Netherlands has implemented MiFID II via three separate laws that amend the Dutch Financial Supervision Act (Wet op het financieel toezicht) and ancillary laws. The laws became effective on 3 January 2018 and are listed below: ▪ Implementing Act MiFID II (Wet implementatie richtlijn markten voor financiële instrumenten 2014); ▪ Implementing Decree MiFID II (Besluit implementatie richtlijn markten voor financiële instrumenten 2014); and ▪ the Regulation competence employees investment firms (Regeling vakbekwaamheid medewerkers beleggingsondernemingen Wft).
Norway	Partially implemented	New temporary regulations incorporating MiFID II and MiFIR entered into force as of 1 January 2018. Note that these are temporary regulations (level 2) and Norway is, as of 24 November 2018, still in a legislative process in respect of implementing MiFID II and MiFIR. The temporary regulations will be replaced at a later stage and the way it is implemented into Norwegian law will differ from the temporary regulations adopted so far.
Portugal	Implemented	MiFID II has been implemented in Portugal through Law no. 16/2015, of 24 February 2015, on collective investment schemes, Law no.18/2015, of 4 March 2015, on private equity firms, social entrepreneurship and specialized investment, and Decree-Law no. 124/2015, of 7 July 2015, amending the Portuguese Securities Code and the Legal Framework of Pension Funds. The new legislation has already come into force. The CMVM is in regular contact with the compliance departments of the main market participants with respect to the importance of implementation. Full implementation of the Directive's requirements by market participants remains a work in progress and CMVM are in email contact with smaller participants asking for status of implementation.
Spain	Partially implemented	Spain has, since 30 December 2017, partially implemented MiFID II with regards to certain aspects on the legal regime of Spanish trading venues (regulated markets, MTFs and OTFs) through Royal Decree-Law 21/2017, of 29 December 2017, on urgent measures for the adaptation of Spanish law to the EU rules on securities markets. Royal Decree-Law 21/2017 came into force on 3 January 2018. The remaining aspects of MiFID II have not been implemented as of 10 January 2018.

Country	Status	Description
Sweden	Implemented	Sweden has, as of 3 January 2018, implemented MiFID II by amending the Swedish Securities Markets Act, (Sw. Lag (2007:528) om Värdepappersmarknaden). The Swedish Financial Supervisory Authority has issued new regulations to implement the delegated directive, Finansinspektionen's regulations regarding investment services and activities (Sw. Finansinspektionens föreskrifter om värdepappersrörelse, FFFS 2017:2), which replaces the old FFFS 2007:16 with the same name. The Swedish FSA also amended the Regulations governing operations on trading venues (Sw. Föreskrifter om verksamhet på marknadsplatser, FFFS 2007:17) to support the implementation of MiFIR. Both FSA regulations entered into force on 3 January 2018. Furthermore, the Swedish FSA has reported that it will comply with ESMA Guidelines and that it considers ESMA Guidelines as general guidelines.
UK	Implemented	Implemented into UK law on 3 January 2018 through a variety of pieces of implementing legislation (see above).

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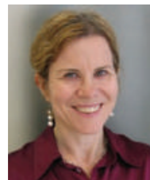

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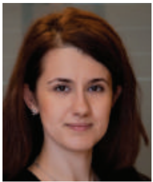

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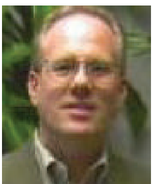

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