

ALLEN & OVERY

Key Regulatory Topics: Weekly Update

5 July 2019 – 11 July 2019



BREXIT

ECB updates FAQs on relocating to the euro area in the context of Brexit

On 5 July, the ECB updated its FAQs on the procedures for the relocation of banks to the euro area in the context of Brexit. The new FAQs relate to: (i) the extension of Article 50 – the ECB states that a hard Brexit is still a very real possibility and could materialise on 1 November. Even if the Withdrawal Agreement is ratified, the end date of the transition period remains unchanged at 31 December 2020. Banks should be fully prepared and are expected to focus their efforts on fully implementing their target operating models; (ii) the ECB decisions (published in March) authorising banks to establish or retain a branch in the UK once it becomes a third country – the ECB will assess the decisions on a case by case basis once the UK withdrawal date becomes clear and consider whether to withdraw or amend them; and (iii) the assessment of internal models – when the UK leaves the EU, there will be a limited period in which new significant euro area banks expanding or migrating from the UK might use internal models that have not yet been approved by the ECB. Such an agreement would be subject to strict conditions, including that internal models must have been approved by the UK supervisory authority and banks must have applied for the internal model approval in the euro area.

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CAPITAL MARKETS

FCA Prospectus Regulation update

On 5 July, the FCA announced that it has decided to delay the implementation of changes to its Electronic Submission System (ESS) that enables it to collect data required by the new Prospectus Regulation which is due to come into effect from 21 July. The delay is due to the fact that ESMA has advised EU authorities that it does not require the full data set to be submitted at present, as pending system changes are unlikely to be completed before mid-2020. As such, the FCA is only making limited changes to the ESS portal for 21 July.

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CONDUCT

FCA final rules on extension of SMCR

On 10 July, the FCA provided an update on its final rules to extend the SMCR to solo-regulated firms. The FCA has been working with HMT to prepare the commencement order required for the FCA to publish its final rules and the new regime will come into force on 9 December as planned. The FCA intends to publish its policy statement on the final rules following publication of the commencement order. The FCA has agreed with HMT a later commencement date for benchmark administrators which will be announced separately.

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FCA deadline extension in certain notifications under SMCR for solo-regulated firms

On 5 July, the FCA announced that it is extending the deadline for FCA solo-regulated firms to submit Form O (notification of change to firm classification) from 9 September to 24 November. The FCA states that if firms decide to opt into the enhanced regime, they must ensure that they are ready to meet all of the relevant requirements, including submitting a Form K (the conversion notification form), statements of responsibilities and a management responsibility map by 24 November.

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CONSUMER/RETAIL

FCA multi-firm review on retail banking: business continuity planning

On 11 July, the FCA announced that it has recently reviewed business continuity planning amongst a number of small and medium-sized retail banks, payment institutions and electronic money institutions. The FCA found that firms often take steps to build resilience to prevent events from occurring, however, anticipating that events will occur and carrying out proper planning will mean that firms are better prepared to respond and recover from events. The FCA assessed the approach taken by firms to: (i) plan and manage business continuity events; (ii) implement business continuity contingencies; (iii) recover and return to normal service following an event; and (iv) identify potential or actual consumer harm and remediate where necessary. Overall, the FCA found that most firms demonstrated a good understanding of the importance of business continuity planning, however, some improvements could be made as some firms did not fully understand the link between large-scale change projects and business continuity planning.

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EBA report on the application of the guidelines on product oversight and governance arrangements

On 5 July, the EBA published a report on the application of its guidelines regarding product oversight and governance arrangements for manufacturers and distributors of retail banking and payment products.

The EBA analysed 30 credit institutions' answers to a questionnaire to identify good practices, and the findings focus on the following five areas: (i) the scope of the guidelines and general governance; (ii) the identification of the target market; (iii) product testing; (iv) product monitoring; and (v) the distribution process. The report found that manufacturers have made positive changes in particular in terms of process and governance; however, in a large number of cases, customer interests did not quite receive the same level of attention as was given to commercial interests and prudential concerns. Furthermore, there may be different understandings of the guidelines within the industry, as was found across different member states, and more clarification may be required to improve convergence across Europe.

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FINANCIAL CRIME

Directive on terrorist financing published in OJ

On 11 July, Directive (EU) 2019/1153 of the EP and of the Council of 20 June was published in the OJ laying down rules facilitating the use of financial and other information for the prevention, detection, investigation or prosecution of certain criminal offences. The EC considered it necessary to adopt this act, because the existing mechanisms to access and exchange financial information while investigating criminal activities are too slow. Furthermore, the number of cross-border cases requiring access to financial information is increasingly growing. The Directive aims to make it easier for law enforcement authorities to obtain financial information in order to prevent, detect, investigate or prosecute criminal offences. It builds on the existing EU framework on money laundering.

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FCA AML Report 2018/19

On 9 July, the FCA published its AML report for 2018/19. In addition to a review of the FCA's activities in this area over the last year, the FCA states that over the coming year, it will continue to monitor firms' progress on improving AML controls as one indicator of whether the potential harm to consumers and market integrity is likely to have reduced. It also proposed to use the Annual Financial Crime Data Return and other information sources to monitor changes in risk over time.

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FCA abnormal trading volume ratio

On 9 July, the FCA published its new abnormal trading volume (ATV) ratio metric, which has been published as part of the FCA's commitment to develop additional metrics to help improve the evaluation of market

cleanliness. The ATV ratio detects if there is an abnormal increase in trading volumes prior to unexpected and potentially price-sensitive announcements. The FCA outlines detailed methodology of the ATV ratio and explains how the key elements of the metric were designed. The ATV metric also covers other financial instruments such as CFDs and spread bets that are traded OTC where the underlying is a relevant equity.

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HMT AML and CTF supervision report

On 8 July, HMT published its AML and CTF supervision report for 2017-18. The report contains several key findings and recommendations, including: (i) each statutory supervisor (the FCA, HMRC and the Gambling Commission) takes a slightly different approach to risk-based supervision, and although some positive steps have been taken, there remains significant weaknesses in the risk-based approach to supervisions among all supervisors, with the exception of the Gambling Commission; (ii) there is an increasing trend in levying penalties for serious systemic AML/CTF failings identified at large multinational firms over the last decade; (iii) for the accountancy and legal sectors, weaknesses in supervision and sanctions are a significant issue which the UK has put steps in place to address; (iv) the FCA should consider how to ensure appropriate intensity of supervision for the different categories of its supervisory population from low to high risk; (v) the FCA should consider the wider use of criminal background checks as part of its processes to ensure that criminals and their associates are prevented from controlling or owning FIs; (vi) the EU published 5MLD in June 2018 and is due to be transposed into UK legislation by January 2020; and (vii) all supervisors should continue to ensure that proportionate, dissuasive and effective sanctions are applied for violations of AML/CTF.

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Eurojust and Europol joint report on common challenges in combating cybercrime

On 5 July, Eurojust and Europol published a joint report that identifies and categorises the common challenges in combating cybercrime. The challenges identified fall into five main areas: (i) loss of data – a lack of unified retention of electronic communication data across the EU presents a key challenge when investigating cross-border cybercrime, and the implementation of CGN technology has led to a serious online capability gap in law enforcement efforts to investigate and attribute crime; (ii) loss of location – recent trends, such as the increasing level of criminal misuse of encryption and/or anonymisation tools, cryptocurrencies and the dark net, have also led to situations in which law enforcement may no longer (reasonably) establish the physical location of the perpetrator, the criminal infrastructure or electronic evidence; (iii) challenges associated with national legal frameworks – differences between domestic legal frameworks in the member state and international instruments often prove to be a serious impediment to international criminal investigation and prosecution of cybercrime, partly due to an incomplete transposition of international instruments into domestic legislation; (iv) obstacles to international cooperation – as there is no common legal framework for the expedited sharing of evidence, even though evidence is preserved, a long period of time may elapse before the evidence is available for the criminal investigation or judicial proceedings in the requesting country; and (v) challenges of public-private partnerships – there needs to be a legislative balance between privacy-related needs and proportionate measures to allow the private sector to continuously support law enforcement in the fight against cybercrime.

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FATF terrorist financing risk assessment guidance

On 5 July, the FATF published a report containing terrorist financing (TF) risk assessment guidance. The report outlines key considerations when determining the relevant scope and governance of a TR risk assessment and highlights practical examples to overcome challenges in relation to information sharing. The report also covers relevant information sources for practitioners when identifying TF risks within the banking and money or value transfer sectors. Furthermore, the report highlights the importance of establishing regular mechanisms to monitor TF risk on an ongoing basis and the importance of continuing to critically reviewing the approach taken to assess TF risk, and identifying blind spots and areas where further information is needed. The FATF notes that the scope, focus and objectives of a TF risk assessment will vary depending on a jurisdiction's threat profile and national context, and there should not be a one-size-fits-all approach in assessing risks.

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FINTECH

Please see the Payment Services and Payment Systems section for the EBA's report on the impact of Fintech on payment and e-money institutions' business models.

MARKETS AND MARKETS INFRASTRUCTURE

ESMA updates MiFID II Q&As on investor protection and intermediaries topics

On 11 July, ESMA published an updated version of its Q&As on investor protection and intermediaries topics under MiFID II and MiFIR. The updated Q&As relate to best execution and the classification of financial instruments under RTS 27.

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GFXC provides further detail on three year review of FX Global Code

On 11 July, the GFXC provided further details from its meeting on 22 and 23 May, in which the committee discussed its mandate to consider the case for a comprehensive review of the FX Global Code at least every three years. Guy Debelle, Chair of the GFXC, states that the code has been in place for a few years now and remains fit for purpose, however, the review will be appropriate to reflect the continuously evolving market structure and dynamics. The GFXC will seek feedback through channels such as local FX Committees, the BIS Triennial Survey of foreign exchange and OTC derivatives trading, and a targeted outreach program.

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ESMA updates Q&As on the CSDR

On 11 July, ESMA updated its Q&As regarding the implementation of the CSDR. The latest Q&As clarify aspects in relation to the scope of internalised settlement reporting, namely: (i) investment firms are not required to report in case they do not execute transfer orders themselves, which they forward in their entirety to a custodian, irrespective of whether the custodian is established in the EEA or not; and (ii) trade netting as such does not qualify as internalised settlement.

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ESMA updates Q&As on the BMR

On 11 July, ESMA updated its Q&As on the BMR. The updated Q&As relate to the commodity benchmark definition, contributions to the euro short-term rate, whether a calculation agent is a user of a benchmark when appointed by an issuer and whether reference to an index in an OTC derivative for the purposes of setting interest on exchanged collateral is use of a benchmark.

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ESMA update on the annual equity transparency calculations under MiFID II

On 7 July, ESMA published an update on the June results of the annual transparency calculations for equity and equity-like instruments under MiFID II. ESMA has recently been made aware of an issue with the updated calculations which seems to affect the results for shares whose main pool of liquidity is in a third country while having less than one transaction a day on average on the most relevant market in the EU. ESMA will revert in due course with a revised set of results for the relevant shares once it has completed investigating the issue. ESMA clarifies that European trading venues are until further notice not bound by the tick sizes outlined in ESMA's June publication for third country shares with an average daily number of transactions lower than one on the most relevant market in the EU.

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PAYMENT SERVICES AND PAYMENT SYSTEMS

Please see the Consumer/Retail section for the FCA's multi-firm review on retail banking: business continuity planning.

PSR market review into the supply of card-acquiring services

On 11 July, the PSR published a consultation paper the aim of which is to explain the PSR's proposed approach to assessing the profitability of card-acquiring services and to invite comments. The market review will consider whether the supply of card-acquiring services is working well for merchants (retailers and service providers), and ultimately consumers. The PSR proposes to use two measures of profitability: return on capital employed and gross profit margin. The PSR proposes to assess the profitability of the supply of card-acquiring services to UK merchants by comparing the profitability of acquirers to various benchmarks and seeing how profitability has changed over time. The proposed period for assessment is the five-year period from 2014-2018. The deadline for comments is 1 August.

[Read more](#)

EBA report on the impact of FinTech on payment and e-money institutions' business models

On 8 July, the EBA published a report on the impact of FinTech on payment institutions' and e-money institutions' (collectively institutions) business models. The report identifies four key drivers that shape and adjust institutions' business models: (i) customer expectations and behaviours – customer intelligence is becoming increasingly important to institutions as a way to make better business decisions, improve customer acquisition, retention and satisfaction, and improve revenue, profitability and value-added services to customers; (ii) competitive pressure – competition is intensified by a number of new players entering the market and the importance of meeting customer demands for fast, reliable, easy and secure payments is amplified; (iii) technological developments – the growth in mobile payments is due to the increase in the mobile use of the internet throughout Europe, which increases the opportunity to access online services. Institutions are progressively leveraging technological developments to integrate alternative payment methods in their systems to offer innovative choices to their customers; (iv) regulatory changes – the introduction of PSD2 is an opportunity for firms to scale up and integrate more technology features into their operations and services as well as to allow FinTech firms to grow and provide consumers with access to more tailored products and services. Currently, some institutions offer a wide variety of payment and e-money services, while some have also obtained credit institution licences and are engaging with FinTech in all possible ways. Institutions seem to be focussing their investments overall on business expansion and internal development when it comes to FinTech. Key challenges for institutions relate to operational resilience and ICT security, operational capacity, regulatory framework, customer education and sourcing and retaining talent. The impact of active participation of BigTech firms and Brexit are key threats facing institutions.

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PSR consultation on merchant survey questionnaire

On 5 July, the PSR published a consultation on a draft of the questionnaire that it proposes to use to conduct its market review into the supply of card-acquiring services. The market review will examine how competition in the supply of card acquiring services operates, including looking at the fees merchants pay for card-acquiring services and the quality of service that they receive. The deadline for comments on the draft questionnaire is 12 July.

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PENSIONS

EIOPA establishes Expert Practitioner Panel on the PEPP Regulation

On 5 July, EIOPA announced the establishment of an Expert Practitioner Panel on the PEPP Regulation. The aim of the panel is to receive feedback and industry insight in order to design a PEPP that exhibits high quality product features around information provision, risk-mitigating techniques and a cost cap for the basic PEPP. The objectives of the panel are to: (i) inform EIOPA's policy work; (ii) test policy proposals; and (iii) act as a sounding board to support EIOPA on delivering its mandate.

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PRUDENTIAL REGULATION

European Court of Auditors' report on EU-wide stress tests for banks

On 10 July, the European Court of Auditors (ECA) published a report regarding EU-wide stress tests for banks. In its report, the ECA focussed on the EU-wide stress test conducted by the EBA in 2018. In particular, it assessed whether the stress test was fit for purpose, whether the EBA had sufficient assurance about the robustness of the figures calculated by the individual banks, and whether the publication of the results allowed stakeholders to conclude whether the system was resilient. The report found that the EBA lacked control over important stages of the process, and therefore important systemic risks were subject to a low level of stress or none at all and the shock was not triggered by events from within the EU financial system, but by economic downturn. The ECA recommends, among other things, that the EBA should: (i) use its legal powers to enhance control over the stress test process; (ii) develop a top-down approach for stress tests to complement the existing bottom-up approach; (iii) request additional resources required to fully carry out its role as specified in the regulation; (iv) ensure that the stress test fulfils its purpose of assessing resilience against adverse market developments, and should vary the stress scenarios from one exercise to another and take account of risks emanating from within the EU financial system.

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EBA progress report on the IRB roadmap

On 9 July, the EBA published a progress report on its 2016 roadmap to repair internal models used to calculate own funds requirements for credit risk using the internal ratings-based (IRB) approach under the CRR. The EBA has focussed predominantly on regulatory aspects and the report marks the finalisation of the regulatory review of the IRB framework and outlines its next steps. Aside from the finalisation of the CRM guidelines, the EBA does not intend to make further revisions to the guidance already set out, as the focus will now be shifting towards implementation.

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ECB guide to internal models

On 8 July, the ECB published the final risk-type-specific chapters of its guide to internal models under the SSM. The chapters cover credit risk, market risk and counterparty credit risk and provide transparency on how the ECB understands the regulations on the use of internal models to calculate own funds requirements.

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RECOVERY AND RESOLUTION

AG opinion on SRB decisions and calculating NRF contributions

On 9 July, AG Campos Sánchez-Bordona gave his opinion on two issues relating to contributions to the SRF and to a NRF: (i) who is responsible for judicially reviewing decisions of the SRB relating to those contributions, where the decisions are notified to banks by a national resolution authority; and (ii) whether, for the purposes of calculating NRF contributions, it is necessary to take into account internal liabilities between institutions in a group of cooperative credit banks or whether those liabilities can be excluded. The AG concluded that the questions referred for a preliminary ruling are inadmissible as regards the decisions of the SRB relating to contributions to the SRF. Those SRB decisions can be challenged only before the Court of Justice and the national courts do not have jurisdiction to annul them. Furthermore, in relation to contributions to the NRF, the exceptions laid down in Article 5(1) of Commission Delegated Regulation (EU) 2015/63 (particularly subparagraphs (a) and (f)) with regards to ex ante contributions to resolution financing arrangements are not applicable to internal liabilities of a cooperative credit bank system of the kind examined in these proceedings. Those liabilities must be taken into account for the purpose of calculating ordinary contributions to the national resolution fund.

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OTHER DEVELOPMENTS

BoE and FPC Financial Stability Report

On 11 July, the BoE and the FPC published its latest Financial Stability Report and financial policy summary and record of meetings of the FPC on 13 June and 4 July. The report sets out the FPC's view of the outlook for UK financial stability, including its assessment of the resilience of the UK financial system and the main risks to UK financial stability, and the action it is taking to remove or reduce those risks. The report looks at: (i) the resilience of the UK financial system to Brexit – the core UK banking system remains strong enough to serve UK households and businesses even through a disorderly Brexit; (ii) global risks - rising trade tensions have resulted in declining business confidence and pose material downside risks to global output growth; (iii) the future of finance; (iv) tackling vulnerabilities in open-ended funds; (v) the transition away from LIBOR – the smoothest transition will be one in which market participants cease new issuance of Libor-linked contracts and identify all existing contracts without appropriate fallback clauses and rectify this to the greatest extent possible; (vi) the UK countercyclical capital buffer – the FPC is maintaining the UK countercyclical capital buffer rate at 1%, however, it is prepared to cut the rate if a major economic stress was to materialise; and (vii) the UK financial system's response to a severe liquidity stress.

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FSB survey of industry practices: cyber incident response and recovery

On 11 July, the FSB published a survey as part of its agreement to develop effective practices relating to a financial institution's response to, and recovery from, a cyber incident. The aim of the survey is to collect information on industry practices from both the financial and non-financial sectors (herewith referred to as 'industry') on response and recovery of critical services, including restoration of data integrity following a cyber incident that could have an impact on financial stability. The FSB requests that completed surveys are submitted by 28 August, although participation is voluntary.

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