ALLEN & OVERY

Workshop and roundtable series for new and growing banks

Slides and materials

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Session 1

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Climbing mountains safely:
the challenges faced by challenger banks

Agenda

1. Climbing mountains safely – an introduction
2. Challenges faced by new and growing banks

Presenters

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Challenges faced for new and growing entrants

Common issues for new and growing banks – firm approach

Systems and controls

Insufficient investment in developing governance, control and capabilities commensurate with evolving needs of the business

Lack of post-authorisation focus

Banks focus on becoming authorised and lose longer term focus on sustainability

Downside scenarios

Insufficient planning to effect an orderly exit

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Regulatory approach & expectations

Overview of approach to supervision

PPRA's primary aim

Promote the safety and soundness of the firms it regulates, whilst recognising the importance of competition in the banking sector.

Proportionate approach

- Assessment proportionate to size and complexity
- Takes account of the fact that new banks are unlikely to meet all the expectations the PRA has of an established bank

Approach has been successful in supporting the authorisation of a number of banks – the PRA has authorised 22 new start-up banks and five in the year to end March 2020.

BUT new and growing banks underestimate work post authorisation to become established

"There remains healthy interest in becoming a bank too, including more than 20 potential UK start up banks in the pipeline. And last year 10% of new lending by banks to businesses was attributable to the non–big six banks, compared to just 4% on average in the period 2012-2018."

Sarah Breeden, Executive Director,
UK Deposit Takers Supervision, 22 July 2020

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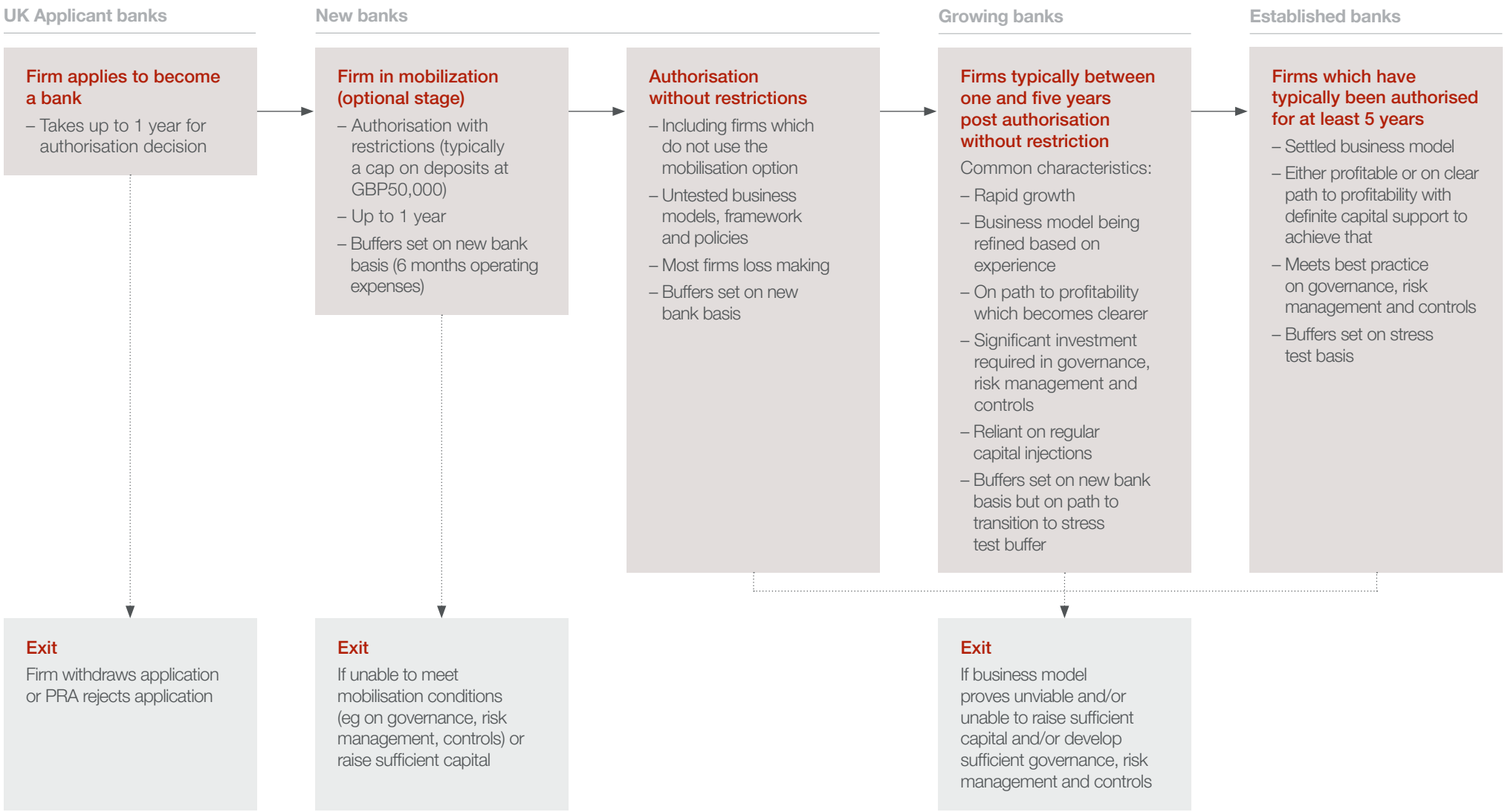
The Journey of a bank from pre authorisation to established bank



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Source: Figure 1, PRA draft Supervisory Statement, 22 July 2020

Scaling the mountain – the PRA's role

Effective competition creates a more diverse and resilient banking system

- Ring-fencing and lower barriers to entry support effective competition.
- **BUT** associated rules and requirements create a perception that they are complex to navigate, fragmented in design and practically impossible to overcome.
- Ability to grow safely
- Adequate contingency plans
- Clear expectations

The need for a well defined regulatory path

- An important part of the financial sector's resilience is its ability to grow safely, and to respond to and to recover from stress.
- The regulator needs to be clear in setting out what is expected so that each bank can make business plans for when things go well and contingency plans for when things go wrong.
- The path up the mountain needs to be clearly mapped out.

"If you're a small bank aspiring one day to be big enough to be ring-fenced, you need to know exactly what is expected of you as you climb that mountain and how the path in front of you might be ascendable, at least in principle."

Sarah Breeden, Executive Director,
UK Deposit Takers Supervision, 22 July 2020

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The PRA's approach to new and growing banks (CP9/20)

The PRA's CP9/20 – An overview of the proposals

Proposals

Expectations of new and growing banks

- Greater clarity over the path to profitability
- Strengthened governance and increased board independence
- Invest significantly in risk management and controls
- Mature control environment required within five years of authorisation

Approach post-establishment

- PRA expects banks to have a positive regulatory relationship through open, constructive and forward-looking communication
- The table on the next slide illustrates the PRA's expectations as the bank matures.

Capital expectations

- PRA buffer for new banks
  - calculated as six months 'operating expenses
  - move onto a buffer set on a stress test basis within five years of authorisation or when profitable
- As the bank grows must develop their stress testing capabilities so prepared to transition.

Orderly exit: recovery & resolution

- Requirement for solvent wind down plans at the point of authorisation (or upon exit from mobilisation)
- These are to be maintained until the bank moves onto a PRA buffer set on a stress test basis.

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The PRA's CP9/20 – expectations for maturing banks

	Year 0	Year 3	Year 5
Business model	Untested business model, most banks loss making	– Business model refined based on experience – Forecasts are more accurate – Clearer path to profitability	– Settled business model – Either profitable or clear path to profitability with definite capital support to achieve that – Realistic forecasts
Governance	Minimum two independent non-executive directors, with strong preference for independent chair	Minimum three independent non-executive directors, including the chair	Meets best practice including, dependent on size and complexity, having a majority independent board
Risk management	– Framework and policies in place – Untested as firm has not yet operated as a bank	– Bank is testing and refining framework and policies in light of experience – Risk management is fit for purpose, with a focus on developing risk management and controls for the most material risks	– Mature control environment – Fully embedded risk management framework linked into stable business model – Framework provides forward-looking view across all risk types – Continuous improvement to ensure framework remains fit for purpose given business and regulatory developments
Capital	– Buffers set on new bank basis (6 months forward operating expenses) – In addition to buffers, banks hold enough capital to meet business plan while remaining above buffers for 12 months – ICAAP in place but untested	– Buffers set on new bank basis (6 months forward operating expenses) – Undertaking advanced stress testing and a clear plan for transitioning to stress test buffer – Forward-looking view of capital to ensure buffers are not used in the usual course of business – ICAAP meets minimum standards and is fit for purpose	– Buffers set on stress test basis – Sophisticated capital management with credible capital models – ICAAP is a robust document which is an integral part of the firm's management process and decision making
Liquidity	ILAAP in place but untested	ILAAP meets minimum standards and is fit for purpose	ILAAP is a robust document which is an integral part of the firm's management process and decision making
Operational resilience	Design operational resilience into business processes and controls from the outset, and follow all relevant policies		
Recovery & resolvability	– Credible recovery plans in place - sufficiently detailed and practical to ensure they would be useable in a stress – Board approved solvent wind down plan in place (while bank is on the new bank buffer approach) – Undertake a forward-looking, realistic assessment of how its preparations for resolution would enable the bank to achieve the outcomes for resolvability – Meet the PRA rules on depositor protection		

Source: Table 1, PRA CP9/20, July 2020

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The Mountain Guide

PRA & FCA Expectations of new and growing banks

The initial years following authorisation involve significant change and development, as banks test and refine their business models and develop the governance and controls to support their growth ambitions.

The governance and controls which are appropriate at authorisation are unlikely to remain appropriate as the bank grows. Investment and development is required to continue to meet the PRA and FCA's expectations

Five areas of focus

Business Models

- Profitability
- Capital generation
- Product development
- Customer centricity

Governance

- Board role
- Board structure
- Succession planning
- Founder conflicts management

Conduct & Culture

- Purpose
- Whistleblowing
- Vulnerable customers

Risk Management & Controls

- Three Lines of Defence
- Risk Management Framework

Outsourcing

- Oversight
- 'Empty shell' focus

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Capital expectations

Capital expectation

Calculation of the New Bank PRA Buffer

- The PRA buffer for new and growing banks is calibrated to allow banks time (around 6 months) to find alternative sources of capital or make business model adjustments, in the event of a loss of investor support.
- Banks are expected to calibrate their PRA Buffer to be equal to 6 months projected operating expenses, defined as those costs associated with the day to day running of the business

Transition and stress testing

- From the point of authorisation, new and growing banks should undertake stress testing as part of their ICAAP and business planning process.
- The ICAAP stress testing work should be proportionate to the scale of the bank, but should be adequate to allow calibration of the PRA buffer on a stress test basis.
- Banks should plan for transitioning to the stress test buffer by building sufficient capital.

Capital management

- Banks should manage their capital position on a forward looking basis and, as outlined in SS31/15, should not use their PRA buffer in the normal course of business or enter into it as part of their base business plan.

Capital quality

- Firms should adopt simple, plain vanilla share structures consisting of only one class of share that is fully subordinated to all other capital and debt, and has full voting rights and equal rights across all shares with respect to dividends and rights in liquidation.

Loss Absorbing Capacity

- The PRA expects firms to meet both MREL and maintain an amount of CET1 capital that reflects their risk-weighted capital and leverage buffers (if applicable)

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Orderly exit: recovery and resolvability

Recovery plans

- Boards of new and growing banks should ensure the bank's recovery plan is credible, realistic and current.
- Banks should ensure certain prescribed considerations are covered in their recovery plans in relation identifying a stress, devising a strategy and testing and improving their recovery planning.

Solvent wind down

- The PRA expects new banks to have a board approved solvent wind down plan in place at the point of authorisation (or exit from mobilisation). Although the new bank buffer has not been calibrated to provide sufficient capital to enact a solvent wind down.
- New and growing banks should maintain their solvent wind down plans, regularly updating them to ensure they remain appropriate as the business develops.
- Banks should maintain solvent wind down plans until they move onto a PRA buffer set on a stress test basis.
- It may be appropriate for the solvent wind down plan to form part of the bank's recovery plan, though boards should consider whether factors such as the size of the bank or emerging threats to sustainability mean a separate solvent wind down plan is more appropriate.

Resolution

- The BoE sets preferred resolution strategies for all banks. For smaller banks that do not supply transactional accounts or other critical functions to a scale likely to justify the use of resolution tools, the preferred resolution strategy is usually the Bank Insolvency Procedure (BIP).
- Under the BIP, the business and assets are sold or wound up after covered depositors have been paid by the FSCS or had their account transferred by the liquidator to another institution using FSCS funds. In order to support this, banks must maintain a single customer view and exclusions file and are required to provide this to the PRA or FSCS within 24 hours of a request.
- As a bank grown, the BoE may change its preferred resolution strategy to either a partial transfer or a bail-in resolution strategy.

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The PRA's approach once banks become established

– The PRA does not have a preference as to where a bank chooses to define its risk appetite.

– Primarily focussed on the potential impact a bank might have on financial stability along with its financial resources and its ability to maintain an appropriate governance and risk management framework to match its chosen risk appetite.

– At certain points in a bank's growth, regulatory requirements increase and banks can expect to be captured by more policy thresholds.

A path to further growth & positive regulatory engagement (5+ years)

– A key aspect to a positive regulatory relationship is being open with the PRA about intentions to adjust risk profiles and business models.

– It is in cases where banks have not been open and not demonstrated the capability to apply increased controls as a result that the PRA has needed to implement its enforcement or statutory supervisory powers.

– This could include varying an authorised bank's permissions or requiring a bank to undertake or stop an action.

Plan for regulatory policy thresholds

– The PRA includes thresholds in policies which are designed to ensure that regulations are only applied to firms when necessary.

– It is important for banks to anticipate within their business plans when they expect to be captured by regulatory thresholds and measure the impact. When a material impact is projected this should be discussed with the PRA.

– When established banks increase their financial stability impact, the PRA will also consider proportionately increasing its supervisory intensity.

Recognise challenge – open to solutions

– The PRA welcomes feedback regarding the impact of its policies and supervisory approach on banks.

– The PRA further welcomes proposals from banks regarding how the PRA can best achieve its objectives.

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Session 2

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Your mountain guide:
navigating regulatory relationships

Agenda

1. Regulatory expectations regarding relationships with firms
2. Challenges for banks
3. Steps towards effective regulatory relationships
4. Benefits of effective regulatory relationships

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Regulatory expectations regarding relationships with firms

UK Regulators and their objectives

The Prudential Regulation Authority (PRA)

- The regulator has two primary objectives
  1. To promote the safety and soundness of firms
  2. To contribute to the securing of an appropriate degree of protection for those who are or may become policyholders (Insurance only)
- They are required to fulfil their objectives by;
- Ensuring that the business of firms is carried out in a way that avoids any adverse effect on the stability of the UK financial system
- Minimising the adverse effect that the failure of a firm could be expected to have on the stability of the UK financial system.

The Financial Conduct Authority

- FCA's strategic objective is to ensure that the relevant markets function well.
- There are three operational objectives to:
  1. Protect consumers – secure an appropriate degree of protection for consumers
  2. Protect financial markets – protect and enhance the integrity of the UK financial system
  3. Promote competition – promote effective competition in the interests of consumers

UK is NOT a zero failure regime

Business Model & Strategy

Control Framework

Operational Resilience

Financial Resources

Individual Accountability

Culture

Governance

CONTENTS

UK regulators' expectations

PRA Fundamental Rules

– **Fundamental Rule 7** – A firm must deal with its regulators in an open and co-operative way, and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice

FCA Principles for Business

– **PRIN 11 – Relations with regulators** – A firm must deal with its regulators in an open and cooperative way, and must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonably expect notice.

Individual Conduct Rules

– **COCON Rule 3** – You must be open and cooperative with the FCA, the PRA and other regulators.

SMF Prescribed Responsibilities

– **(4) Responsibility for the firm's obligations for… (b) conduct rules reporting** – the firm's obligations for conduct rules reporting means its obligations under section 64C of the Act (Requirement for authorised persons to notify regulator of disciplinary action)

PRA advice to new banks

One factor that invariably assists a bank in "climbing the competitive and regulatory mountain" is "the strength of their relationship with the PRA… Relationships with the PRA need to be open, honest and constructive… As I hope you have gathered by now, we do not like surprises, and I suspect firms do not like them either."

Sarah Breedon, Climbing Mountains Safely[1]

Bank of Scotland (BOS) GBP45M fine for failures to disclose information

"Whilst BOS did not intend to breach Principle 11, it failed to give proper consideration to the need to disclose the suspicious information that it had identified to the [FCA]… On any reasonable basis, BOS should have appreciated that it was required to inform the [FCA] fully about the information which raised suspicions that a significant fraud may have occurred and this failure constituted a substantial failure by BOS"

FCA Final Notice[2]

1. https://www.bankofengland.co.uk/speech/2020/sarah-breeden-climbing-mountains-safely

2. https://www.fca.org.uk/publication/final-notices/bank-of-scotland-2019.pdf

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Supervisory interactions and level of focus

Supervisory interactions with banks

- Meetings
- Business Model Changes
- Onsite Visits
- Remediation Programmes
- MI Requests
- Board, ExCo Observation
- SMF Interviews/Approvals
- s.166 Reports
- Risk Assessments
- Incidents
- Regulatory Reporting
- Corporate Events

A regulator's overall impression and judgment of a firm is formed across varied and numerous interactions

The number, frequency and level of focus across all these will increase as the your firm grows in size, nature, and complexity.

Effective steps towards regulatory relationships are essential, regardless of whether your firm is:

Newly authorised

- currently less regulatory focus, but plans to grow in the short and medium term

Established

- experiencing heightened regulatory scrutiny having grown since initial authorisation

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Supervisory intensity – driven by impact

Categories of firm
PRA: 1 to 5
FCA: Firm vs Portfolio

In times of stress – market-wide or for an individual firm – supervisory intensity will likely increase

HIGHEST

LOWEST

Sole Trader IFA, Small Credit Union

Regulatory returns

Securities firm
(solo regulated)

5 Conduct Questions Meeting

Thematic review

Regulatory returns

Fast-growing Challenger Bank
(dual regulated)

30+ meetings

2 major reviews

MI requests

SMCR interviews

Risk Assessment every 2-3 years

Major Asset Manager
(solo regulated)

50+ meetings

3 major reviews

Quarterly MI provision

Risk Assessment every 2-3 years

Major Banking Group
(dual regulated)

500+ meetings

c. 20 major reviews, including remuneration, stress testing, vulnerable customers, IRB models, mortgage sales, IT framework

Board, Risk and Audit Co observation

Annual Risk Assessment

As bank increase in size and complexity, so too will supervisory scrutiny

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Challenges for banks

Common challenges for banks

Regulatory expectations

- Understanding of what is expected – interpreting rules and guidance
- Individual supervisors' approaches and attitudes
- Regulatory horizon – continued high volume of change
- Cost of regulation

Regulatory resourcing models

- Ability of portfolio firms to gauge what is expected
- Lack of supervisory continuity on complex issues
- Response times on critical matters
- Demands on senior management

Where to pitch engagement – Principle 11

- Major departures
- Red IA reports
- Severity of incidents
- Press coverage
- International regulatory issues

Regulatory co-ordination

- Perception of who is in the lead – SMCR
- Conflicts between objectives – cost of customer remediation v capital
- Remuneration
- IT & Cyber
- Market wide exercises eg CBEST testing
- Supervisory colleges – domestic and international

Examples of when to notify the PRA (PRA draft SS: PRA's approach to new and growing banks)

- **6.3.** A key aspect to a positive regulatory relationship is being open with the PRA about intentions to adjust risk profiles
- **6.6.** When a material impact from new regulatory policy thresholds is projected this should be discussed with the PRA

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Steps towards effective regulatory relationships

Regulatory engagement

Governance

- Firm wide governance on regulatory engagement – eg a regulatory engagement policy that defines who can talk to regulators, governance around information submissions, how to track delivery against commitments, record keeping
- Relationship with regulators should be part of a firm's risk management framework – Principle 11
- Consider which regulators are covered – ensure joined up approach where necessary

Roles and responsibilities

- An individual or team should be assigned responsibility for managing the 'day to day' regulatory relationship
- This might sit within compliance, legal, or another function depending on the firm
- Depending on a firm's size, it may have a dedicated regulatory affairs function or individual
- Regardless of who is responsible for "managing" the relationship, the Board, senior management team and key functions all have a role to play in owning regulatory matters and communicating effectively with regulators

Communicating effectively

- Clear articulation of roles and responsibilities is important for a number of reasons and scenarios:
  - Raising sensitive issues with regulators, for example context on press articles or senior manager conduct
  - Relaying important messaging from regulators, for example concerns about individuals' attitudes, responsiveness to requests or feedback on the quality of risk management
  - Incident management and emergency contacts

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Activities and processes

Managing Regulatory Communications and Commitments

Managing communications across, and commitments arising from, all supervisory meetings and information requests from regulators

Two key aspects:

- **Process** – coordinate and record all correspondence; handle senior committee (eg Board) paper submissions; track commitments arising from meetings; track actions against risk mitigation programme (RMP) and other action points
- **Strategic** –
  - Briefings to senior leadership ahead of regulatory interactions
  - Provide quality assurance and consistency of messaging on any materials provided to regulators

Firms should:

- **Be proactive** – make the most of opportunities to hear directly from the regulators
- **Join the dots** – firms can learn a lot from the questions they are asked. This can enable firms to anticipate and address concerns

Submission of selected formal documents and forms:

- Selected Regulatory Returns – for example, organogram, list of regulators
- Variations of Permissions (VOPs) and waivers

Regulatory Change

Regulatory horizon scanning:

- Understand the regulatory agenda and its potential impact to the firm, keeping the firm up-to-date on key pieces of regulatory change, enabling the firm to plan for priorities
- Its not just about the rules – wider context to understand evolving regulatory expectations (eg speeches, final notices, Dear CEO letters)
- Understanding the regulatory agenda – including the emphasis and focus indicated through wider regulatory publications such a speeches – can help inform a firm's approach to regulatory relationships, as well as anticipate lines of questioning and MI requests

Regulatory implementation:

- Ensuring key pieces of regulatory change implementation are "handed off" to appropriate owners within the business/functions
- Oversight and coordination – this will increase in importance as the bank grows, and regulatory changes impact different areas of the business to different degrees
- Regulators expect banks to be "on top of" regulatory change implementation

Strategy and advocacy:

- Take a strategic approach to priority pieces of regulatory policy change, including through discussions with senior leadership and actions to engage in the development of the regulatory agenda
- This may include meetings with policymakers, regulatory consultation responses, briefings to internal senior leadership

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Mindset and behaviour

Understand the regulators' objectives

- Regulators will consider risks that firms or individuals pose to their objectives
- Consider how your business model, purpose, and behaviour can complement the regulators' objectives

Tone and approach

- Professional and appropriately formal
- Speak the regulators' language – eg customer centric (FCA) and prudently minded (PRA)

Be open and collaborative

- Be honest around skills and development points
- Report breaches of compliance as soon as possible, but with plans to learn lessons and address issues

Take broader responsibilities seriously

- Articulate your firm's approach in cross-cutting focus areas, eg culture, governance, conduct risk, etc
- This helps demonstrate that you take broader responsibilities (in addition to immediate commercial interests) seriously

Balanced Strategy and Purpose

- Provide a balanced view of your firm's strategy, demonstrating understanding of risks, realistic growth targets, and wind down plans.

Body Language and Mannerisms

- Be patient and considerate in explaining technical details.
- Your experience and credentials may be challenged – do not get defensive

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Benefits of effective regulatory relationships

Engaging with regulators – enforcement lessons learned

Bank of Scotland – 2019 (Fine: GBP45.5m for breach of Principle 11)

Failed to alert the regulator about suspicious conduct, including fraud, when it first became apparent. Over the next two years, on numerous occasions, Bank of Scotland failed properly to understand and appreciate the significance of the information that it had identified despite clear warning signs that fraud might have occurred.

Santander UK Plc – 2018 (Fine: GBP32.8m, including GBP12.6m for breach of Principle 11)

Santander failed to disclose information relating to the issues with the probate and bereavement process to the FCA. Santander did not notify the FCA of the nature or extent of the issues it faced, including the numbers of potentially affected customers and assets, and was selective in the information it provided.

Bank of Tokyo Mitsubishi UFJ Limited (BTMU) – 2017 (Fine: GBP17.85m)

BTMU failed to be open and cooperative with the PRA in respect of information relating to enforcement action taken against it by the New York Department of Financial Services (DFS). While the action was focused on matters which related to BTMU's conduct in New York, it was apparent to BTMU that there was a sufficiently serious risk of further DFS action. Further, it should have been considered that the possible range of outcomes of an action and a potentially significant adverse impact on BTMU's reputation, may have had prudential implications for the global business.

Sonali Bank (UK) Limited (SBUK) – 2016 (Fine: GBP3,250,600, including GBP140,000 for breach of Principle 11)

While under investigation for another breach relating to its AML governance and control systems, SBUK breached Principle 11 by failing to notify the regulator for at least seven weeks that it had become aware of a potentially significant fraud having occurred.

Bank of Beirut – 2016 (Fine: GBP2.1m for breach of Principle 11)

Concerns about the culture became apparent following supervisory visits to the firm in 2010 and 2011. Subsequently, Bank of Beirut was required to take a number of remedial actions to address concerns of financial crime. However, Bank of Beirut did not complete a full remediation exercise within the agreed timeframe and repeatedly assured the regulator that it had addressed all concerns even though this was not the case.

Co-operative Bank 2015 (Sanction: public censure)

As part of an investigation into the breach of Listing Rules, Co-op Bank failed to notify the regulators about intended changes to two senior positions and the reasons for those changes.

Benefits

Effective Regulatory Relationships

- Fewer regulatory surprises
- Greater confidence from regulator in firm's ability to manage crystallised risk events
- Room for discussion with regulators on productive points of value for the firm
- Better understanding of regulatory expectations

Ineffective Regulatory Relationships

- Time and resource drain – on whole business
- Additional regulatory requirements
- Risk of crossed wires
- Increased scrutiny

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Session 3

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Training your team for the climb:
a focus on culture and conduct

Agenda

1. **Key questions to consider**
2. **The four 'drivers' of culture that have been identified by the UK regulators:**
   - **Leadership**
   - **Purpose**
   - **Managing and rewarding people**
   - **Governance**

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Key questions to consider

Do you think that most of your firm's employees could confidently explain its corporate purpose?

Have you read your firm's whistleblowing policy?

Has the leadership style of your firm changed over the last year inlight of Covid-19?

We are going to structure our discussion around the four 'drivers' of culture that have been identified by the UK regulators

Leadership

- Key challenges
- What does 'bad' look like?
- What does 'good' look like?
- Leadership in times of crises

Purpose

- What is it?
- The 'tone from within'
- Keeping purpose at the core of firm
- Key challenges

Managing and rewarding people

- Impact on culture
- Tackling misconduct
- What does this look like for a modern workforce?
- Keeping things proportionate

Governance

- Key pitfalls to avoid
- Embedding governance arrangements
- Ensuring that governance actually 'works'
- The Senior Managers and Certification Regime

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Session 4

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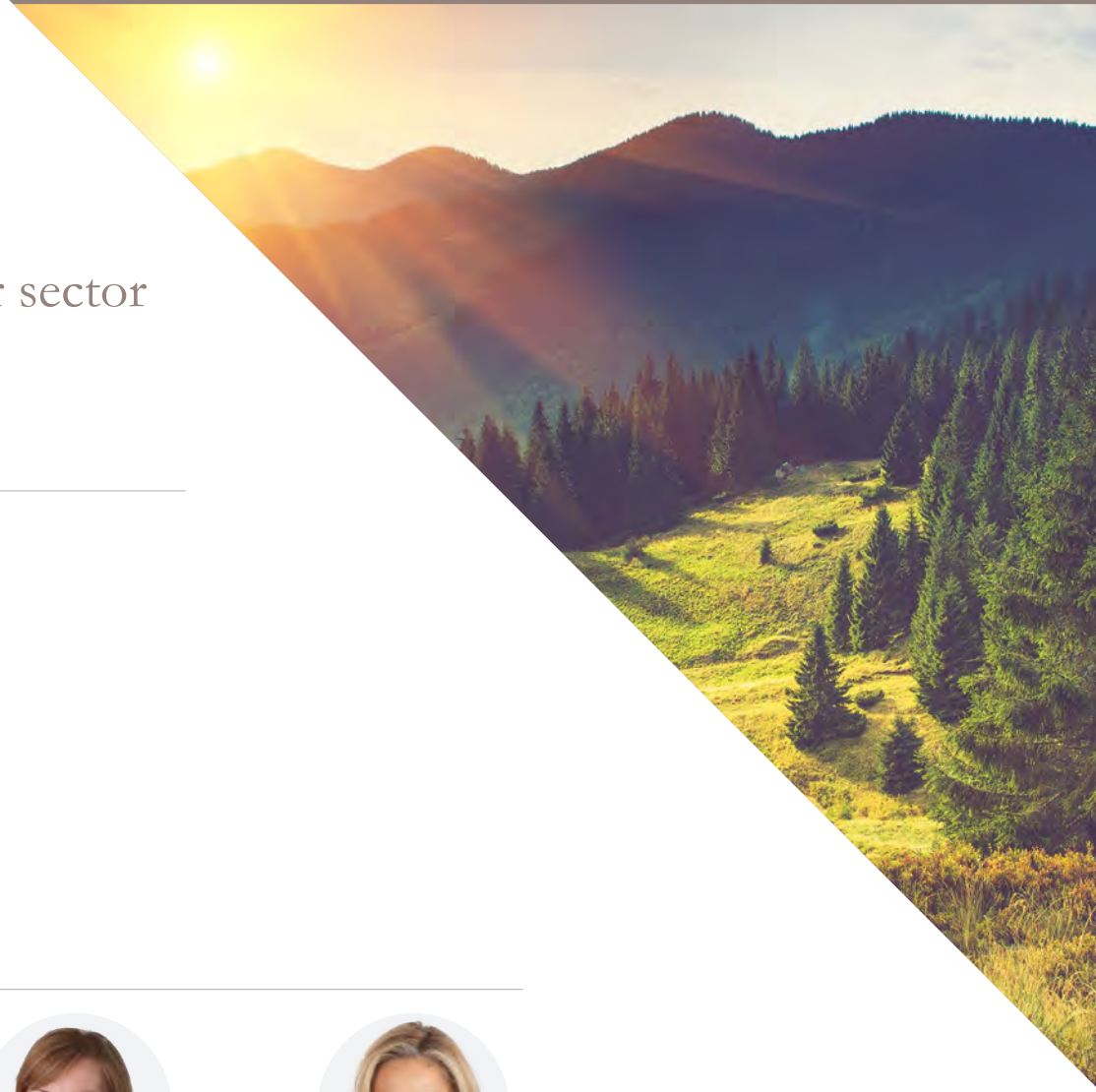
Responsible mountaineering: understanding the ESG landscape in your sector



Agenda

1. Key drivers for rise of sustainability
2. Opportunities for challenger banks
3. A focus on social objectives
4. Prudential issues
5. TCFD and TNFD
6. Litigation risk

Presenters

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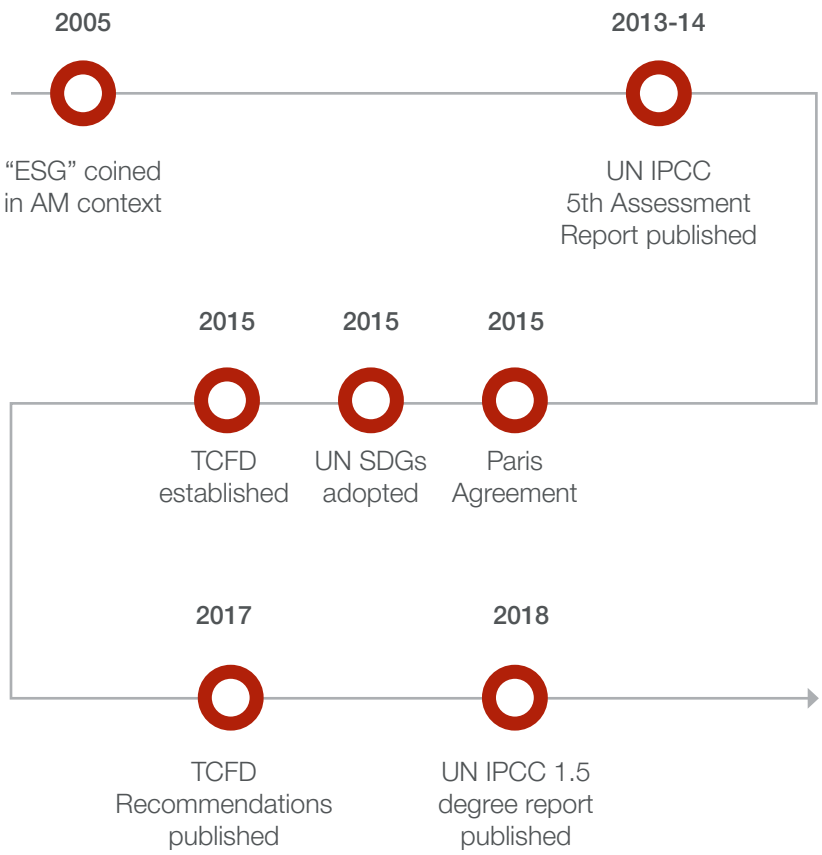
Key drivers for rise of sustainability

Drivers for the rise of sustainability



Multiple levers advancing the sustainability agenda

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Opportunities for challenger banks

- Sustainability and social benefit as a USP
- New, managed supply chains
- Custom built MI, reporting and disclosure
- ESG driven investment products
- Alignment of values
- Asset base unencumbered by legacy ‘high carbon’ assets
- Brand loyalty
- Workforce engagement
- Proportionality
- Financial inclusion

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A focus on social objectives

What are social objectives?

- How the bank manages community engagement, how well it protects human rights and employee relations.
- Fair practice
- Consumer protection
- Diversity
- Profits vs social cost

How do social objectives dovetail with FCA expectations?

- The FCA's **Principles for Business** require firms to treat customers fairly and the FCA expects firms to exercise particular care with vulnerable consumers.
- Covid-19 has reversed the positive trend in vulnerability. There are now 27.7 million adults with characteristics of vulnerability, up 15% since the pandemic started.
- Whilst Covid-19 has sharpened regulator focus, the key themes of protecting those in financial difficulty and ensuring consumers get fair value and can access financial services and products are not new.

"Social purpose increasingly matters to consumers, employees and shareholders – people want to engage with, work for and invest in, firms that are purposeful."

Jonathan Davidson, Executive Director of Supervision – retail and authorisations, November 2020

CONTENTS

Social objectives – FCA areas of focus

Examples of key areas

1. **FCA Business Plan 2020/2021:** FCA priorities include ensuring consumer credit markets work well and that firms deliver fair value in a digital age.
2. **FCA Guidance on the fair treatment of vulnerable customers:** The FCA wants to see a practical shift in firms' actions and behaviours.
3. **The Woolard Review:** The recommendations envisage a large-scale programme to reform the way that consumer credit is regulated with a view to improving outcomes for consumers

Socially responsible products/ services and consumer protection

- **Innovation and reshaping the regulatory framework**
  - Opportune time for firms to think about customer need and improve access to affordable credit
- **Fair and ethical treatment of all customers but especially those who are vulnerable customers**
- **Fair and effective product design and delivery**
- **What does good practice look like?**
  - *Acting with an appropriate level of care avoiding harm*
  - *Providing a choice of communication methods*
  - *Increasing staff understanding of the needs of vulnerable consumers*
  - *Understanding and responding to the evolving needs of different clients*
  - *Tailoring customer service to meet the needs of a consumer*

Not accepting profits at any social cost

- **Fair and ethical pricing**
  - Not simply about the cost of products but also the way in which firms make money
  - Product disclosures – can consumers understand what their money buys them?
- **Real understanding of what customers need?**
- **Protection of access to cash and access to credit**
  - Not everyone can access mainstream credit
  - Cash remains a vital payment method despite technological advancements

Diversity and non-discrimination

- **More effective and ethical use of data**
- How can data be used to ensure that products and services are: (i) diverse and not taking advantage of known biases; and (ii) ethically priced?
- **Diversity**

"Financial services generally are not diverse and that is not a good thing for anyone. But it is also important to remember that diversity is one thing and inclusion is another; without an inclusive culture, the value of diversity, when achieved, will not be realised".

Georgina Philippou, Senior Adviser to the FCA on the Public Sector Equality Duty, January 2021

CONTENTS

Prudential issues

The prudential angle

Climate Risk

- **Physical risks:** Risks posed by extreme weather events, and the frequency of occurrence eg loss of premises due to flooding
- **Transition risks:** Risks associated with transition to a low carbon economy eg stranded assets risks
- The market has also flagged **litigation risk**

Financial Risk

Risk of a sudden, major collapse of asset values which will generate a credit cycle or a business cycle

A *"climate Minsky moment"*

Risks

- To value of bank's assets (eg loans to petrochemical companies; damage to real property serving as collateral),
- To insurers (eg increase in storms),
- Associated with investor demand,
- To macro-economy (eg impact of change in projected earnings)

"I am not asking [firms] to hug a tree but to manage their financial risk"

Sarah Breeden, Bank of England (BoE), January 2019

CONTENTS

Current prudential requirements

PRA Rulebook/Onshored CRR

Disclosures

Operational risk

Market risk

Strategies and process

Governance arrangements

Management body

PRA PS 11/19 and SS 3/19: Enhancing banks' and insurers' approaches to managing the financial risks from climate change

A proportionate response, maturing over time and in light of evolving best practice

Governance

- Board oversight
- Evidence of how the firm monitors and manages the financial risks from climate change in line with its risk appetite statement
- Appointment of responsible SMF(s)

Scenario analysis

- To inform firms' strategic planning and determine the impact of the financial risks from climate change on their solvency and liquidity
- Apply a range of scenarios over different time horizons

Risk management

- Identify, measure, monitor, manage, and report on their exposures to financial risks arising from climate change
- Update risk management policies
- Evidence how they will mitigate these financial risks and to have a credible plan or policies in place for managing exposures

Disclosure

- Pillar 3 disclosures
- Strategic Report under the UK Companies Act
- Engage with other initiatives (eg TCFD) and seek to promote better disclosure across the industry (ie via their own investments)

CONTENTS

Dear CEO letter, 1 July 2020
Thematic review of firms' SS3/19 plans

Response

– Strategic responses need to be clearer.
Continue developing tools that inform business decisions.

– Need for greater oversight of climate related financial risks.

Strategy

– Few firms have implemented integrated policies, thresholds, mitigation strategies, monitoring capabilities and risk appetites.

Timing

– Firms should have fully embedded their approaches to managing climate-related financial risks by the end of 2021.

Development

Enhanced capabilities needed to support

– Integration of scenario analysis into broader risk analysis.

– Disclosures, which have been limited.

Data limitations

– Metrics and quantification the most challenging aspect of risk assessment.

– Acknowledgement that it won't be possible to embed a full end-state analysis by end-2021.

Additional guidance

– CFRF guidance on climate disclosure, risk management, scenario analysis & innovation.

– BoE additional guidance (eg reference scenarios) ahead of the 2021 BES.

CONTENTS

Key developments – what does the future hold?

Introduction

- CRRII/CRDV and the IFR/IFD extend several mandates to the EBA in the area of sustainable finance Directive
- **BUT** impact of Brexit

EBA mandates

- **SREP:** EBA to develop a report assessing the potential inclusion of ESG risks in the supervisory review and evaluation process
- **Disclosures:** EBA to develop a technical standard for including ESG risks in the Pillar 3 disclosure requirements
- **Prudential treatment:** EBA to assess whether a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives would be justified (Pillar 1).

UK approach

- Post-Brexit – not automatically onshored
- PRA statement – December 2020

CONTENTS

TCFD & TNFD

Litigation risk

Global trends in ESG litigation

- Greenwashing
- Securities
- Disclosure
- Tort

Session 5

CONTENTS

Funding the climb:
raising funds and building a balance sheet positioned for growth

Agenda

1. Introduction
2. Secured funding
3. Lifecycle of a growth company
4. IPOs – things to consider
5. Own funds and options for issuance

Presenters

Michael Bloch
Partner

Tom Grant
Partner

Sally Onions
Partner

Will Samengo-Turner
Partner

CONTENTS

Secured funding

Asset funding options

Typical types of funding
Private warehouse
Public securitisation
Future flow sales
Covered bonds

Timing/life cycle

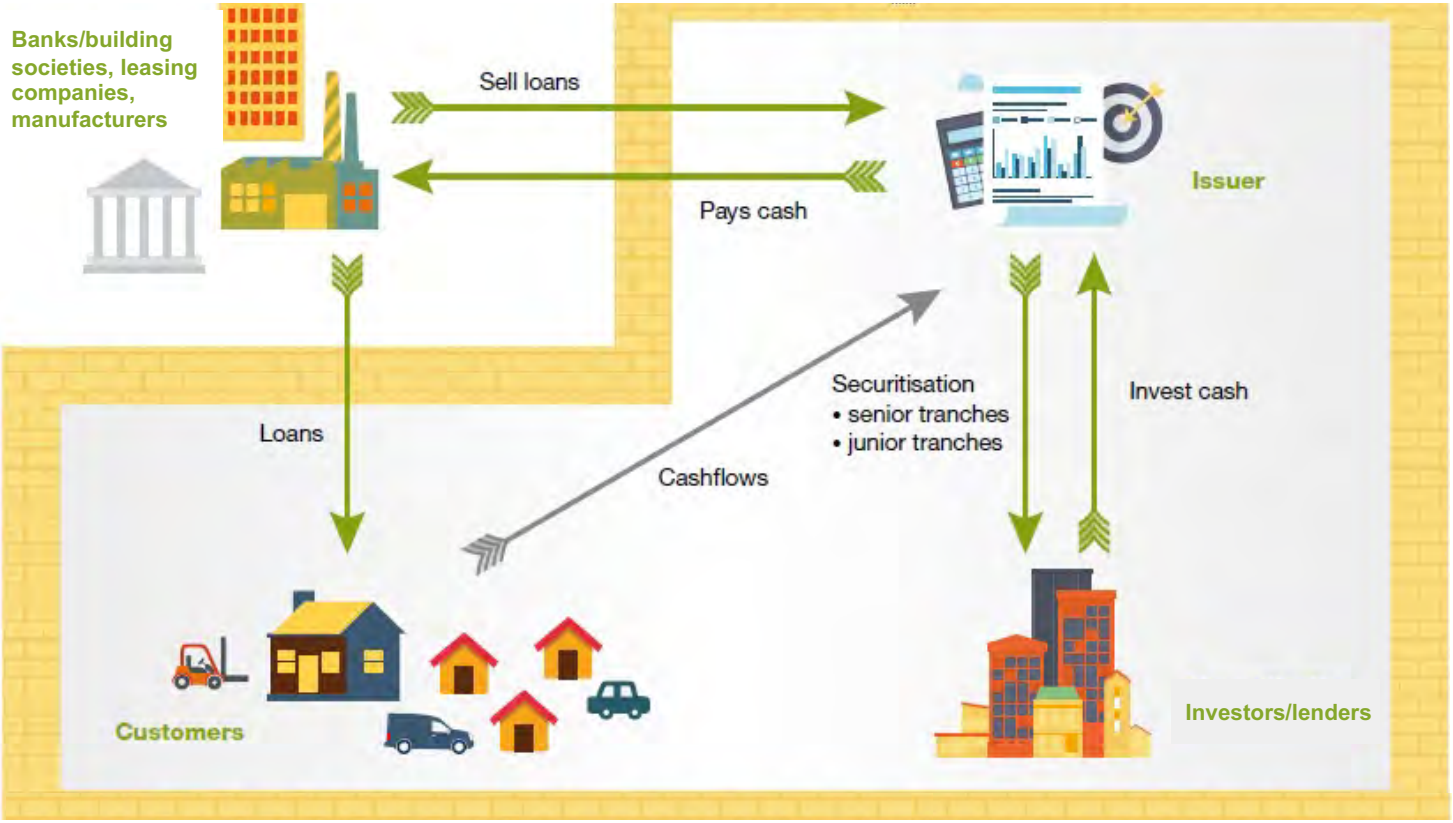
Flexibility and funding goals

Liquidity vs Capital

CONTENTS

What is securitisation?

Securitisation is a mechanism for financing real-economy assets by ring-fencing them and protecting the cashflows they generate for the benefit of investors/lenders who receive what the ring-fenced assets generate. No more, no less.



Although list of assets that may be securitised is potentially endless (with different structures employed), the fundamentals are relatively basic and common to nearly all types of deals

Source: AFME publication "European securitisation: an essential tool to fund economic growth", June 2016

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Goals in structuring

– Segregate or "ring-fence" the assets from originator's bankruptcy

– Protect cash flows from events of bankruptcy and originator's other business

– Enhance the cash flows to achieve as high a rating of the bonds as possible

– High degree of certainty with regard to the overall costs – no unexpected/unaccounted costs, including tax

– Meet criteria of rating agencies to achieve a high credit rating than the bank (but note that not all deals (particularly private deals) are rated)

Why do a warehouse?

Flexible funding tool
Warehouse funding is an established and widely used model that offers greater flexibility relative to traditional securitisation/RMBS and an alternative funding option allow for the building up a portfolio large enough for a full RMBS

Can be part of business strategy
Can be used when setting up new origination lines to fund advances made to borrowers – "wet funding"

Potentially less costly and less complex
The costs and complexity will largely depend on how the arrangement is structured

CONTENTS

Why do an RMBS? (note issuance)

Funding
Non-recourse, competitive costs of funds (not funding against credit risk of the originator), maturities, diversify lending sources

Liquidity (post financial-crisis)
– Immediate funding, including from central banks (Bank of England) and from other banks (use in Repos)
– Can also get financing against your junior tranches

Off-balance sheet treatment of securitised assets/regulatory capital relief
Increased return on capital

Why do a forward flow?

Funding
Allows for sale of assets, ongoing servicing/origination fees

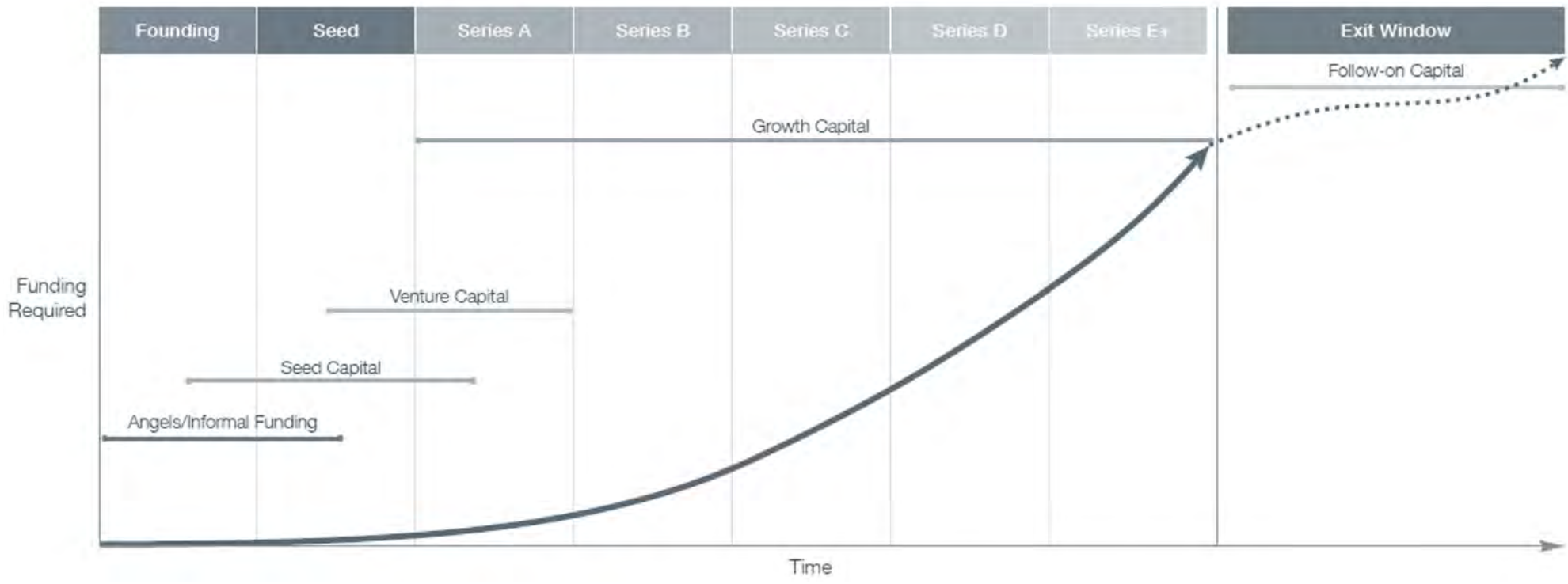
Capital relief
Sale of assets – free up capital without limiting origination capacity

Originate different products
Can allow banks to originate assets no appetite to hold on-balance sheet (eg high LTV loans)

Preparation

1. Due diligence – vendor due diligence knowing your portfolio
2. Reporting and IT
3. Servicing Structure
4. Policies and procedures
5. Assessing corporate/ board appetite

Life cycle of a growth company



CONTENTS

How can legal maintain "heightened readiness"?

Weekly

- Maintain clear contractual database
- Change of control/indemnities/ non-compete/onerous terms register
- Up-to-date record keeping on cap table and consents (what does the fully diluted look like?)

Monthly

- Board/committee packs
- Consider data room maintenance
- Risks register

Quarterly

- Run "mock" disclosure/DD exercise
- Consider undertaking/reserved matters provisions on current equity documentation
- Regulatory filings check

Annual

- Equity documents audit – what works well and what needs to change?
- Ongoing runway/long-term funding plans
- Exit readiness plan

CONTENTS

Key points to consider at term sheet stage

Control rights
– Negative control/veto rights
– Board seats
– Observer rights
– Purely an economic investment?

Rights over IP
– Is exclusivity necessary or desirable?
– Is certain IP more sensitive
– Right of first look

Economics
– Liquidation preference and anti dilution
– Preferential dividend
– Pay-to-play
– Option pool

Key Warranties
– IP
– Regulatory/compliance
– Employee issues
– Accounting requirements

Other terms
– Non-compete
– Drag/tag/co-sale
– Pre-emption rights

CONTENTS

Specific points for corporate venturing

Strategic investors will often have different priorities to purely economically minded VCs

1. Rights over IP
2. Requirement to enter into separate commercial arrangements
3. Marketing requirements
4. Right-of-first-look on products
5. Walk-away right/“kill switch”
6. PR strategy
7. Specific regulatory/consolidation risks

IPOs – things to consider

Timeline for IPO execution

Process and organization of initial public offering

Preparation	Analyst education	Investor education	Roadshow/bookbuilding	Pricing/allocation	Aftermarket
T- 4/6 months	T-10 weeks	T- 4 weeks	T- 2 weeks	T	T+

1 Preparation

- Business plan/capital structure
- Corporate governance
- Corporate structuring
- Preparation of financial statements
- Financial, commercial and legal due diligence
- Agreement on offering structure
- Drafting of prospectus and other offer documentation
- Regulatory review/discussions
- Underwriting/sponsor documents
- Early investor dialogue/ meetings

2 Analyst education

- Management presents to syndicate analysts at analyst presentation
- Pre-deal research notes prepared
- Audited financial accounts finalised
- Key investors identified
- Management preparation for deal launch

3 Investor education

- Finalise preliminary prospectus/regulatory sign-off
- Sales forces briefed by management
- Announce intention to float
- Pre-deal research published
- Analysts investor meetings
- Syndicate to assess initial demand profile and recommend indicative price guidance and roadshow plan

4 Roadshow

- Price range announced to the market
- Roadshow launch
  - Management start meeting with investors
  - One-on-one and group meetings
- Bookbuilding process begins
  - Banks take orders from investors to buy shares

5 Pricing

- Closing of book
- Demand review
- Pricing decision
- Execute underwriting agreement
- Allocation of shares to investors
- Payment of funds to the company and shareholders

6 Aftermarket

- On-going research and trading support
- Market making
- Corporate broking relations
- Potential inclusion in indices

Preparation phase | Market execution phase

CONTENTS

Becoming a public company

Cultural changes

– Separation and independence from shareholders
– Accountability to, and interaction with, a wider range of stakeholders
– Public scrutiny and assessment

Management changes

– Institution of additional governance
– Separation of duties
– Recruitment of additional staff (non-executive directors, investor relations etc.)
– Incentivisation

Regulatory changes

– Ongoing financial reporting obligations
– Compliance with listed company disclosure rules, including announcements
– Controls around certain corporate actions

Private company → **Public company**

Process takes time, and can distract management from their operation of the business

CONTENTS

IPO readiness is a precursor to IPO execution

Strategy
IPO value journey
IPO destination
Equity story and offering concept

Structure
Issuing company
Group structure
Maintenance of influence

Systems
Internal controls and procedures
Information management
IT systems
Compliance framework

IPO process
IPO windows
Appointment of advisors
Plan B options
Internal resources

IPO readiness considerations

Leadership
Senior management and board of directors
Remuneration/ESOP
Corporate governance

Financial
Reporting policies and processes
Forecasting
Prospectus

Functions
Investor relations
Compliance officer
Committees

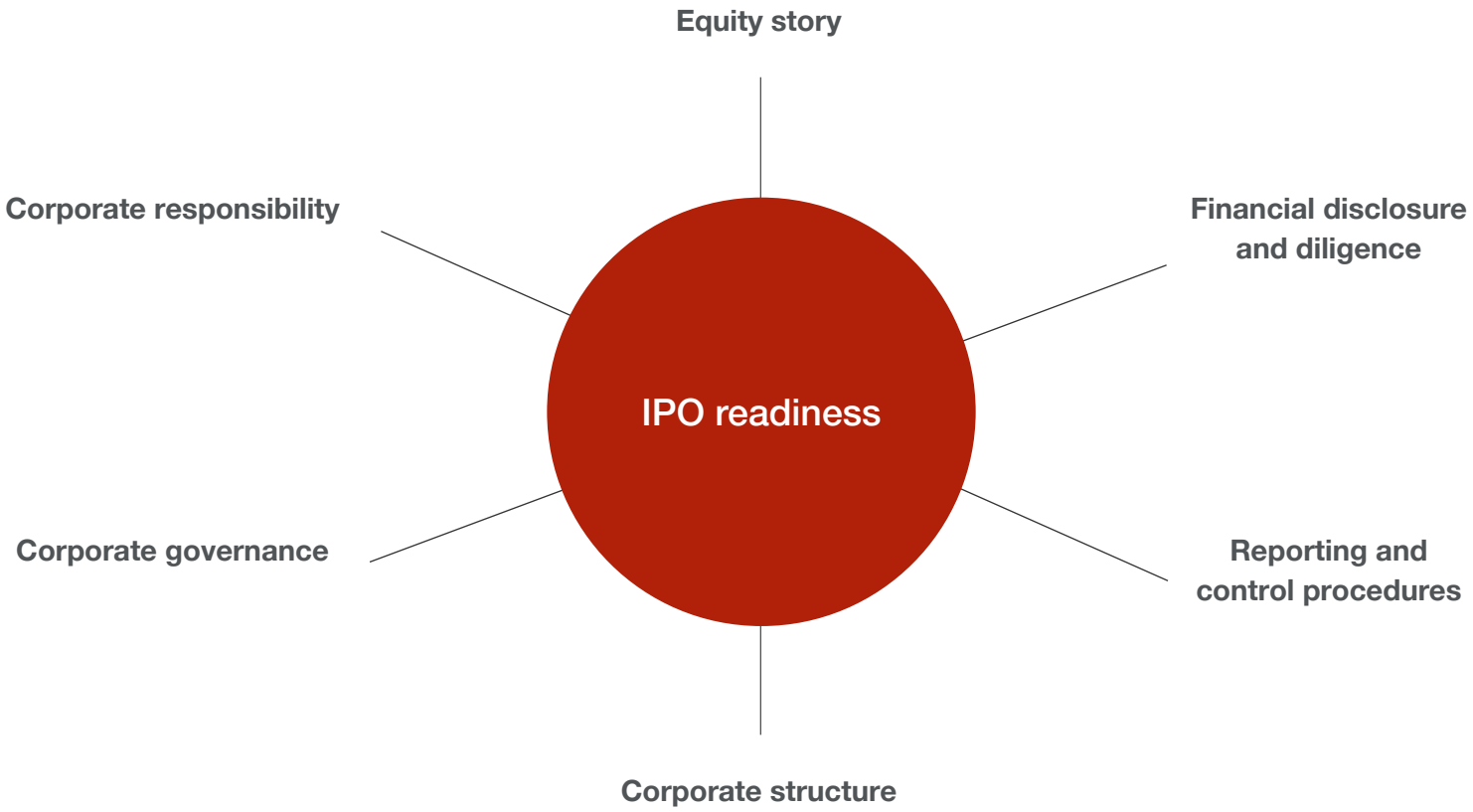
Taxes
Company level
Shareholder level
Transaction level

IPO readiness is a separate, comprehensive process that the issuer will be assisted with by the accountants, legal counsel and financial advisors before the launch of the IPO execution process

CONTENTS

Pre-IPO considerations

Ensuring IPO readiness not only leads to time and cost savings during the listing process, but can also positively impact equity valuation.



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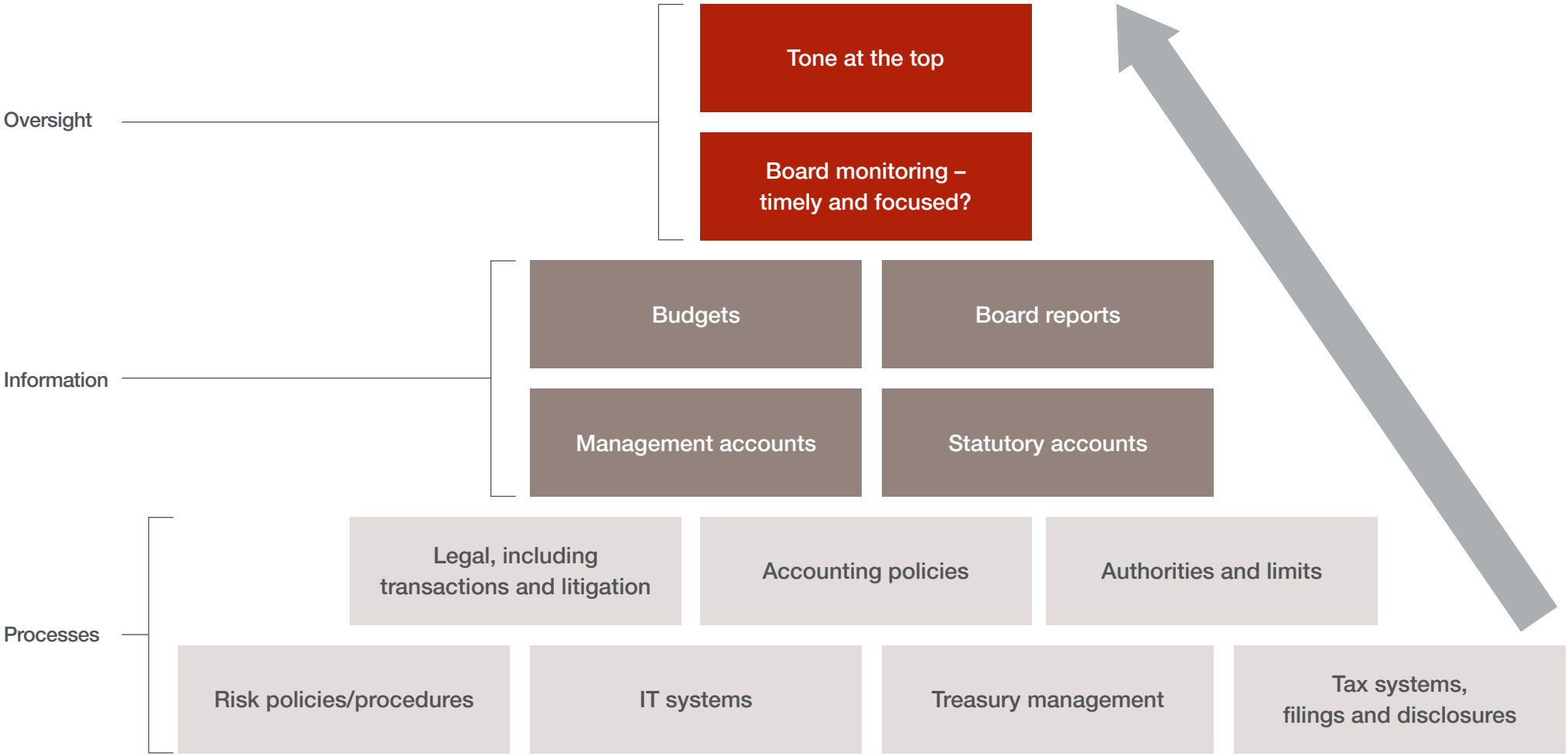
Reporting and control procedures

Listed companies require a foundation of robust processes on which to build a financial reporting structure.



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Key considerations when planning for an IPO

It is important to understand the time and resources involved in preparing for an IPO, and to plan accordingly.

1. Ensure management and shareholder objectives are aligned
2. Establish of a core team responsible for the day-to-day implementation of the IPO; agree reporting lines and decision making procedures
3. Engage early with certain advisers
4. Review existing shareholder agreements, and consider implementing shareholder IPO conduct arrangements
5. Identify and understand work streams, their interaction and milestones; agree budgets
6. Address early any issues that may impact the deliverability or timing of the IPO

CONTENTS

Own funds and options for issuance

Additional Tier 1 – core terms

1

Term
– Perpetual, with calls

2

Deeply subordinated; unsecured

3

Distributions
– Discretionary (cancellation not deferral)
– Not credit-sensitive
– Pay out of "distributable items"
– Subject to MDA if buffers not met in full
– No dividend stoppers

4

Not cause balance sheet insolvency
– Solvency condition

5

Limited events of default

Additional Tier 1 – loss absorption

1

Contractual loss absorption at fixed trigger point

2

Trigger level
– CET1 ratio falls below 7 per cent

3

Form of loss absorption
– Considerations (pre-IPO – price/risk of dilution)
– Permanent Write-down vs conversion to equity and in full under UK regime
PLUS write-down/conversion under Banking Act

CONTENTS

Tier 2 – core terms

1. **Term**
   – 5 years or more maturity, with calls
   – Regulatory amortisation over last 5 years → 10NC5 structure

2. **Subordinated; unsecured**
   – Fixed claim on winding-up
   – Junior to depositors, senior debt and eligible liabilities

3. **Distributions**
   – Can be mandatory

4. **Limited events of default**

PLUS write-down/conversion under Banking Act

Spectrum of issuance options

Private placement

Uncleared

Unlisted

Transfer restrictions

Unlisted bond (not suitable for Holdco)

Cleared

Dataroom instead of disclosure

Listed bond

Cleared

Fulsome disclosure

May be small number of investors or public issuance

EMTN Programme

For repeat issuance with rapid market access

CONTENTS

Session 6

CONTENTS

The right team for the climb: achieving proportionality in governance, risk management and staffing

Agenda

1. Regulatory expectations regarding governance, risk management and staffing
2. Governance
3. Risk Management
4. Staffing

Presenters

Claire Haydon
Executive Director,
A&O Consulting

Tom Anderson
Executive Director,
A&O Consulting

Sarah Hitchins
Partner

Robbie Sinclair
Partner

CONTENTS

Regulatory expectations regarding governance, risk management and staffing

What do regulators expect?

"As banks grow and mature following authorisations, they should… strengthen governance and increase the independence of the board as they mature; and expect to invest significantly in risk management and controls, and have a mature control environment typically by five years after authorisation."

PRA CP9/20: Non-systemic UK banks

"Our expectations of boards are high – and rightly so. Good, proactive governance is key to delivering a sound and well-run business. And, I should note, the opposite is often a leading indicator of a firm in trouble, and the root-cause of firm failure."

Sarah Breeden, 'Climbing Mountains Safely' speech

"Supervision of their governance seems to be even more important for small firms than for large ones."

Sam Woods, 'Strong and Simple' Speech

"Banks should ensure they regularly assess whether their controls remain fit for purpose in the context of changes to the business, and whether there is a clear framework for risk identification, management and mitigation."

Draft SS (July 2020): Non-systemic UK banks

CONTENTS

The PRA's CP9/20 – expectations for new and growing banks

	Year 0	Year 3	Year 5
Business model	Untested business model, most banks loss making	– Business model refined based on experience – Forecasts are more accurate – Clearer path to profitability	– Settled business model – Either profitable or clear path to profitability with definite capital support to achieve that – Realistic forecasts
Governance	Minimum two independent non-executive directors, with strong preference for independent chair	Minimum three independent non-executive directors, including the chair	Meets best practice including, dependent on size and complexity, having a majority independent board
Risk management	– Framework and policies in place – Untested as firm has not yet operated as a bank	– Bank is testing and refining framework and policies in light of experience – Risk management is fit for purpose, with a focus on developing risk management and controls for the most material risks	– Mature control environment – Fully embedded risk management framework linked into stable business model – Framework provides forward-looking view across all risk types – Continuous improvement to ensure framework remains fit for purpose given business and regulatory developments
Capital	– Buffers set on new bank basis (6 months forward operating expenses) – In addition to buffers, banks hold enough capital to meet business plan while remaining above buffers for 12 months – ICAAP in place but untested	– Buffers set on new bank basis (6 months forward operating expenses) – Undertaking advanced stress testing and a clear plan for transitioning to stress test buffer – Forward-looking view of capital to ensure buffers are not used in the usual course of business – ICAAP meets minimum standards and is fit for purpose	– Buffers set on stress test basis – Sophisticated capital management with credible capital models – ICAAP is a robust document which is an integral part of the firm's management process and decision making
Liquidity	ILAAP in place but untested	ILAAP meets minimum standards and is fit for purpose	ILAAP is a robust document which is an integral part of the firm's management process and decision making
Operational resilience	Design operational resilience into business processes and controls from the outset, and follow all relevant policies		
Recovery & resolvability	– Credible recovery plans in place - sufficiently detailed and practical to ensure they would be useable in a stress – Board approved solvent wind down plan in place (while bank is on the new bank buffer approach) – Undertake a forward-looking, realistic assessment of how its preparations for resolution would enable the bank to achieve the outcomes for resolvability – Meet the PRA rules on depositor protection		

Source: Table 1, PRA CP9/20, July 2020

CONTENTS

Governance

PRA's expectations of boards of new and growing banks

Draft supervisory statement, July 2020

"The PRA is open to novel and untested business models, but expects to apply a higher degree of scrutiny to these banks to ensure governance and controls are appropriate and the bank understands the risks it is taking on."

- Board plays a pivotal role in ensuring **sustainable growth**, with ability for **orderly exit** if required
- Boards should:
  - proactively identify and address potential weaknesses in the **business model or control environment**, demonstrating self-awareness and a willingness to tackle issues early on
  - ensure the bank has a forward looking approach to **capital management**, with clear triggers for when actions need to be taken to enable the bank to continue to meet total capital requirements plus buffers
  - ensure the **risks of rapid growth**, or new ventures and products, are appropriately controlled before embarking on these
  - provide **independent oversight and challenge** and oversee the development of risk management and controls
- Skills - **adequate collective, relevant experience** to understand the bank's business model, key risks, and set its strategy
- Plan for **evolution of the Board** – ongoing development of existing members and succession plan for changing skill sets required at different stages of development
- Appropriate checks and balances to identify and **manage conflicts of interest** – specifically where **founder is CEO**
- All directors should be able to make their own sound, objective and independent decisions and judgements – shown during discussions and decision making at the Board
- New banks should expect to invest significantly in developing governance, controls and capabilities in their early years

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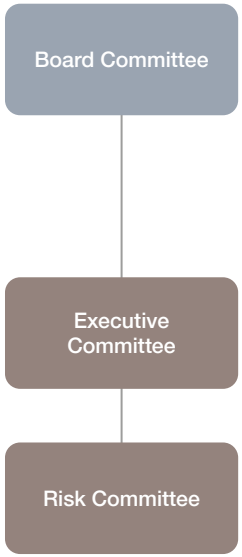
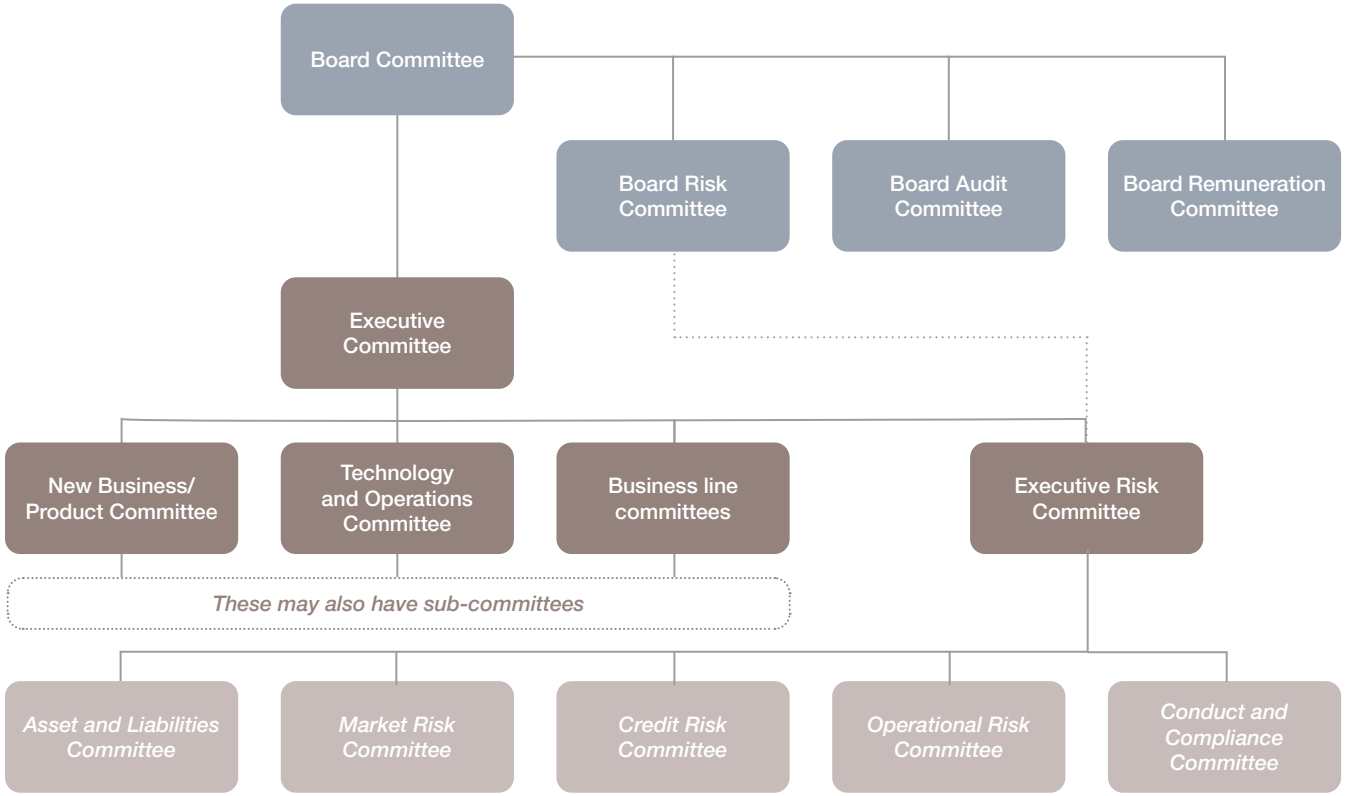
Governance frameworks – simple to more complex

Simple structure



As your firm grows in size and complexity, so too will the structure of your governance framework

More complex structure



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Banks are required to implement the Senior Managers and Certification Regime when they are approved by the FCA and the PRA

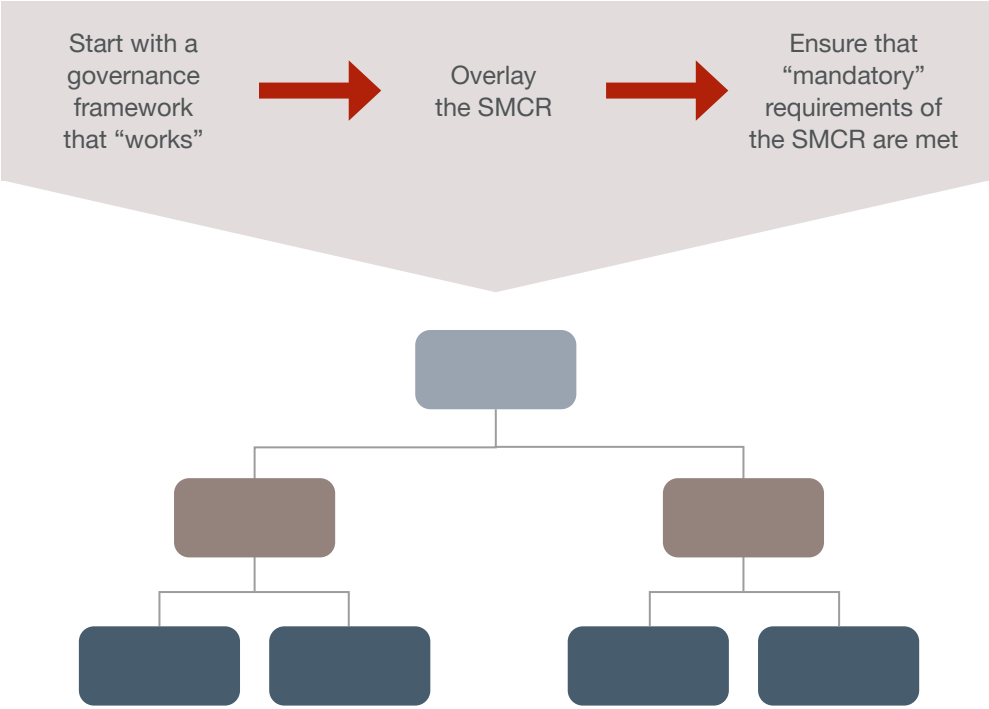
Senior Managers Regime
Focusing accountability on a small number of senior individuals.
Subject to FCA approval
– *Must be fit and proper to perform roles*
– *Regulatory references must be requested*

Certification Regime
Not subject to FCA approval but must be assessed as fit and proper
– *Must be fit and proper to perform roles*
– *Regulatory references must be requested*

Code of Conduct
Applies to all employees of in-scope entities, with the exception of those who perform "ancillary functions"

Firms have a degree of flexibility in terms of how they implement the Senior Managers and Certification Regime

Implementing the SMCR



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Governance considerations

Roles and responsibilities of Board, ExCo and committees clear in terms of reference	Effective linkage between Executive and Board level governance framework	Regular reporting established, including required management information
Decision making powers and delegation of authority clear	Record keeping – appropriate minutes and action tracking	Defined escalation process, both business as usual and times of stress
Regular reviews of operating effectiveness – feedback mechanisms in place	Proportionate to size and complexity of the firm	Group and subsidiary roles

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Governance in practice

Common issues

- Lack of forward planning and prioritisation for Board agenda
- Decisions not escalated in time for meaningful Board input
- Executive team unclear on what the Board expects of them
- Skills matrix not updated to reflect changing business or regulatory priorities
- Challenges managing the change from start up to steady state
- Focus on financial risks at the expense of non-financial risks
- Lack of first line ownership of risk and control issues
- Board papers unclear on purpose, with excessive detail or insufficient information
- Busy agendas leaving limited time for strategic discussions
- Under-resourced Company Secretary function

What makes an effective Board?

Elements of an Effective Board

Leadership and culture

- Clear purpose and strong leadership
- Clarity between the role of the Board and Executive Committee
- Strategic focus – help develop business model, strategy, controls and culture
- Oversight of performance and delivery
- Culture and appropriate behaviours

Open channels of communication

- Building Board relationships
- Effective relationship with senior management team
- Escalation works effectively, judged appropriately
- Wider business and stakeholder engagement

High quality decision making

- Rigorous exploration of issues
- Constructive debate and robust challenge
- No dominant voice
- Aligned with business model and risk appetite

Balanced Composition

- Right balance of skills, experience and independence
- Diversity and different perspectives – avoid group think
- Succession planning

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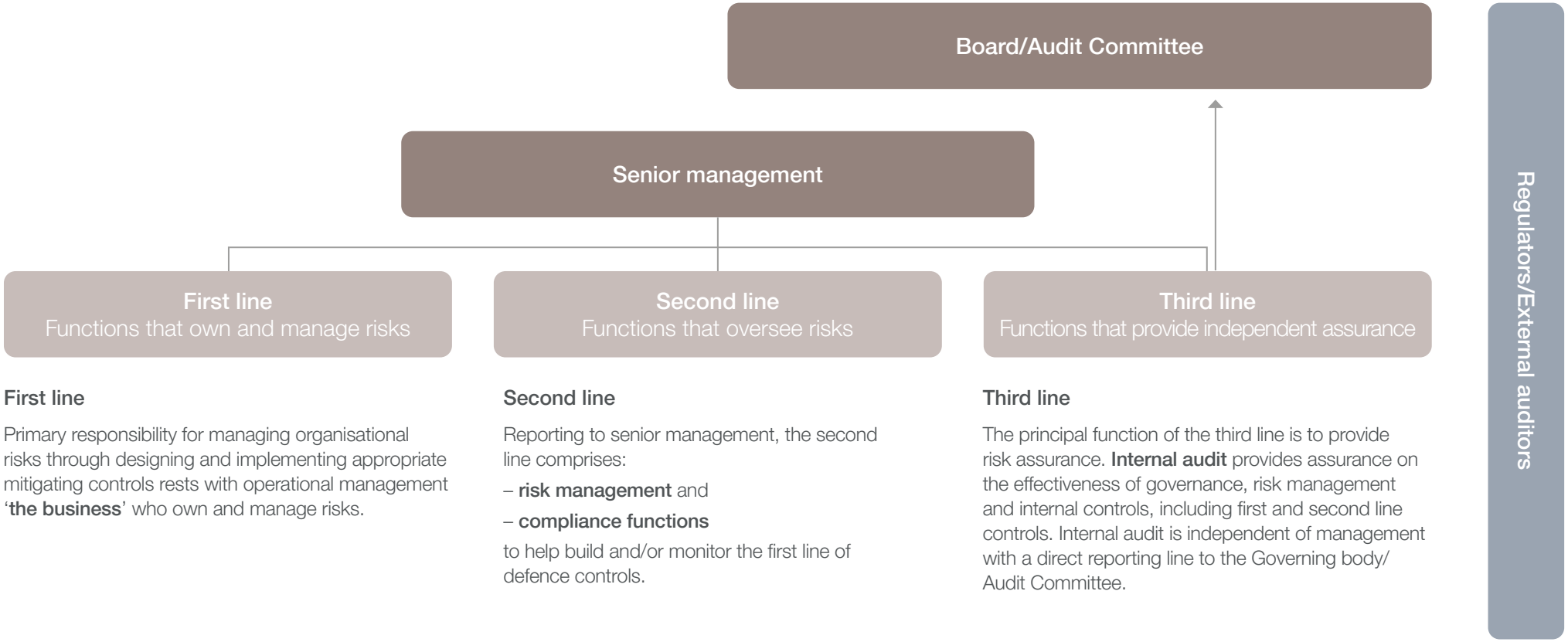
Risk Management

3 Lines of Defence



First line

Primary responsibility for managing organisational risks through designing and implementing appropriate mitigating controls rests with operational management '**the business**' who own and manage risks.

Second line

Reporting to senior management, the second line comprises:

– **risk management** and

– **compliance functions**

to help build and/or monitor the first line of defence controls.

Third line

The principal function of the third line is to provide risk assurance. **Internal audit** provides assurance on the effectiveness of governance, risk management and internal controls, including first and second line controls. Internal audit is independent of management with a direct reporting line to the Governing body/ Audit Committee.

CONTENTS

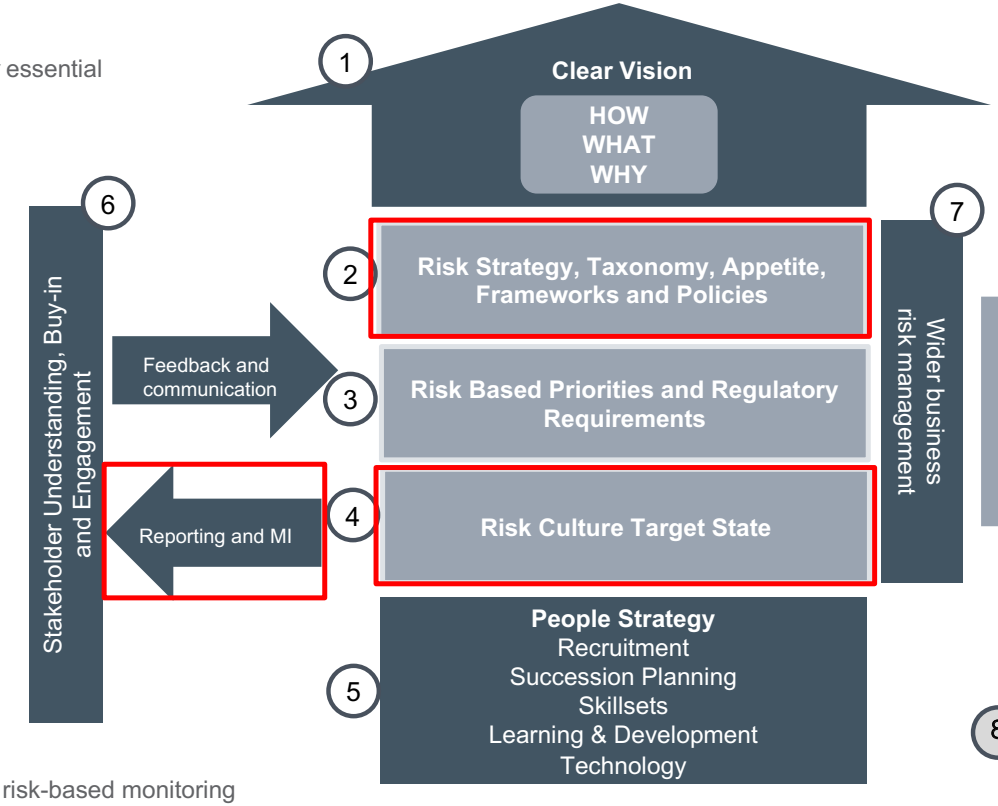
The high performing Risk Function

Key components of a high performing Risk Function and suggested focus areas to address over time:

1 **Clear Vision**
- Define the *how, what* and *why* essential to the Risk vision

2 **Risk Management**
- Articulate areas of priority, including how the function supports the prudent delivery of the firm's business strategy
- Conduct gap analysis between regulatory requirements and firm risk appetite, policies and procedures
- Review risk management framework design and deliver enhancements

3 **Risk Based Priorities**
- Assess framework for periodic risk-based monitoring
- Review regulatory requirements 'footprint'



4 **Risk Culture**
- Understand firm wide risk culture
- Deliver bespoke training and embed "learning" ways of working

5 **People Strategy**
- Review skillsets against current/predicted needs

6 **Stakeholder Buy-in**
- Gain consensus on remit
- Establish authority to challenge

7 **Business Ownership**
- Ensure first line ownership of risk agenda

8 **Future Focussed**
- Develop/enhance external horizon scanning mechanisms
- Deliver technology solutions for Risk function

CONTENTS

Risk Framework – key components and best practice

Risk Strategy	A risk strategy that is a structured plan of action that defines how risk is identified, assessed and managed, supporting the successful execution of business strategy in line with risk appetite across all risk stripes.
Risk Taxonomy	A risk taxonomy that covers the most material risks faced by the firm, within a clear hierarchy (levels one, two and three) which is understandable for the first line and is used across all three lines of defence as a framework for reporting.
Risk Appetite	A board approved risk appetite that details the amount of risk the board(s) is willing to take in pursuit of the firm's strategic aims and objectives. In the context of a group, the risk appetite of the firm should be capable of aggregation to support an overall group risk appetite.
Risk Frameworks	A set of key risk frameworks (level one) that defines the approach to the management of specific risk stripes, providing context and guidance for effective risk management across the firm.
Risk Policies	A set of clear, concise policies (typically for level two and three risks) which out the rules for managing risks so that the firm operates within risk appetite and in line with its objectives.
Risk Metrics and Reporting	A coherent, timely and accurate set of risk metrics that provide senior management with a comprehensive view of the current and prospective risk profile of the firm across the most material risk areas. Risk aggregation enables consolidated reporting across business units and individual legal entities.
Risk and Control Effectiveness and Operation	Defined internal control standards that set out the minimum standards that must be met by all controls. Comprehensive risk and control effectiveness processes, with a focus on continuous improvement in risk and control management.

CONTENTS

Reporting risks – levels

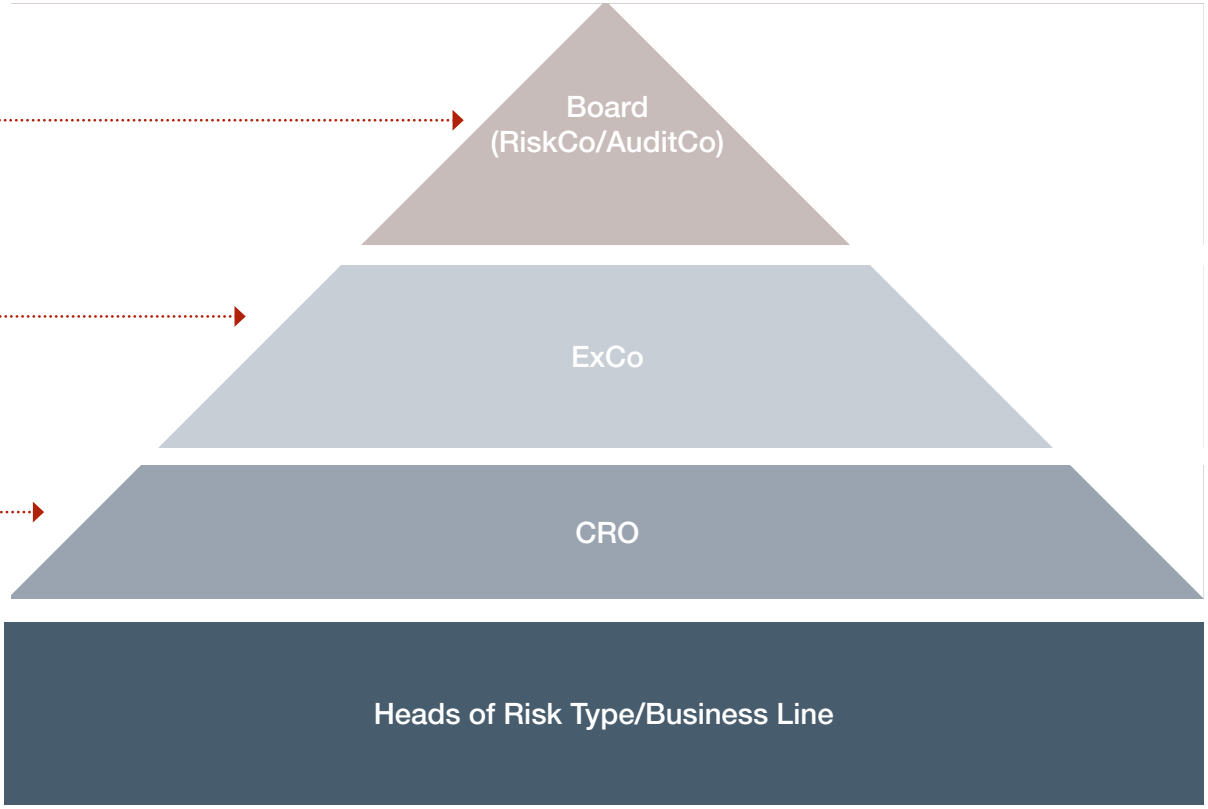
When building reporting packs, you should use the same data (for efficiency) but give different levels of detail depending on the audience's needs

The Board needs high level that give an aggregate view of risk across the organisation

ExCo needs similar level to the board but individuals need to have a view of risk in their own area

The CRO needs a more detailed view of risk across organisation

The Head of each risk type or business line (eg Head of Operational Risk) needs granular information, diving into each area



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Embedding risk culture

Although risk culture is not tangible, the behaviours that flow from it can be observed and monitored.
There are several key elements contributing to a positive firm wide risk culture that can be influenced by a CRO, as outlined below.

Positive Risk Culture

Leadership

– Senior managers are seen to live the firm values and lead risk management by example, holding individuals and each other accountable

Workplace behaviours

– Poor behaviours that damage risk culture are not tolerated (eg personal agendas, conflicts of interest etc.)

Communication

– Employee feedback about risk management is welcomed – bad news is not supressed and whistle blowers are protected

Support

– Leaders actively provide resources, training and support needed for positive risk culture to flourish

Engagement

– Managing risk is seen as a personal responsibility integral to decision making and part of performance evaluation

Risk as a Priority

– Managing risk is widely perceived as a priority for successful operation

– Senior management maintains an enterprise wide risk focus

CONTENTS

Staffing

The Senior Managers and Certification Regime is relevant to resourcing decisions

Accountability

Allocate and document responsibilities to Senior Management Functions (SMFs) so it is clear who is responsible for what.

Conduct standards

All staff must comply with internal and external conduct standards (including the FCA/PRA Code of Conduct).

Delegation and supervision

Senior Managers can delegate responsibilities to an appropriate person provided that they are effectively overseen.

Fitness and propriety

Senior Managers and Certified Persons must be fit and proper to perform their roles.

Resourcing and capability

Monitor resourcing needs and capacity or capability of team – address gaps (including through appraisals and training).

Change management

Do not forget about succession planning and handovers between Senior Managers.

SMCR is relevant throughout the employment lifecycle

Hiring

- Hiring stage assessment (SMFs and CPs)
- Handover (SMFs)
- Introduction to conduct rules and firm values (all)

Exits

- Regulatory references (SMFs, CPs and potentially others)
- Handover (SMFs)

Annual Cycle

- Ongoing assessment of F&P and annual certification (SMFs and CPs)
- Leadership and culture (SMFs)
- Training on conduct rules and values (all)

ER Issues

- Serious competence and capability issues (all)
- Conduct issues (all)
- Notification of CR breaches to FCA (SMFs and CPs)

CONTENTS

The FCA regards "people policies" as a key driver of culture

"People policies are, in particular, the types of behaviour that are incentivised or disincentivised within the firm and how this is done…"

The FCA has emphasised the importance of firms tackling non-financial misconduct

"Poor culture in financial services can lead directly to harm to consumers, market participants, employees and markets. It was a key root cause of recent major conduct failings within the industry. How a firm handles non-financial misconduct throughout the organisation, including discrimination, harassment, victimisation and bullying, is indicative of a firm's culture. We view both lack of diversity and inclusion, and non-financial misconduct as obstacles to creating an environment in which it is safe to speak up, the best talent is retained, the best business choices are made, and the best risk decisions are taken."

FCA 'Dear CEO' letter to general insurance firms, January 2020

CONTENTS

The FCA's focus on 'non-financial misconduct' has extended well beyond sexual misconduct

Sources: Various FCA publications and speeches

CONTENTS

Review whistleblowing procedures

1. Review procedures in light of changing regulatory expectations, risk areas and firm culture
2. Consider appropriate routes for escalation – particularly in respect of disclosures involving non-financial misconduct
3. Consider how regulatory obligations are met through different escalation routes
4. Culture and D&I considerations
5. Developments in employment litigation
6. Trends in reports to PRA/FCA

CONTENTS

The FCA is especially focused on the risks that are associated with employees working remotely

- The FCA has expressed concerns about increased and different work-related conduct risks that are associated with employees working remotely.
- The FCA has also warned firms about increased non-work-related conduct risks that are associated with employees working remotely.
- We have seen examples of employees who are less likely to raise concerns or ask questions of their supervisors and/or Compliance when they are working remotely.

Key points: Working remotely

Employee wellbeing

Employee (mis)conduct

Effective delegation and oversight

Managing employee performance

CONTENTS

Session 7

CONTENTS

The right equipment for the climb: designing and launching a profitable product mix that meets customers' needs

Agenda

1. New product approval considerations
2. Overview of the key product types
3. Product case studies: crypto, credit and savings
4. Product design and oversight

Presenters

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Partner

Tom Anderson
Executive Director,
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Partner

Joanne Owens
Counsel

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Product approval considerations

New product approval considerations

As products increase in volume and complexity, so too will supervisory scrutiny

Ideation → **Launch**

- New initiative raise
- Market research and scoping
- New Entity and/or license required
- Internal and external testing for product launch
- Product launch, and product monitoring and review

Key product types

Open Banking style products:

– Account information service provision

– Payment initiation service provision

Examples

– Crypto
– Savings accounts
– Insurance
– Share trading
– P2P lending
– Credit
– Digital wallets and loyalty/referral programmes
– Mortgages

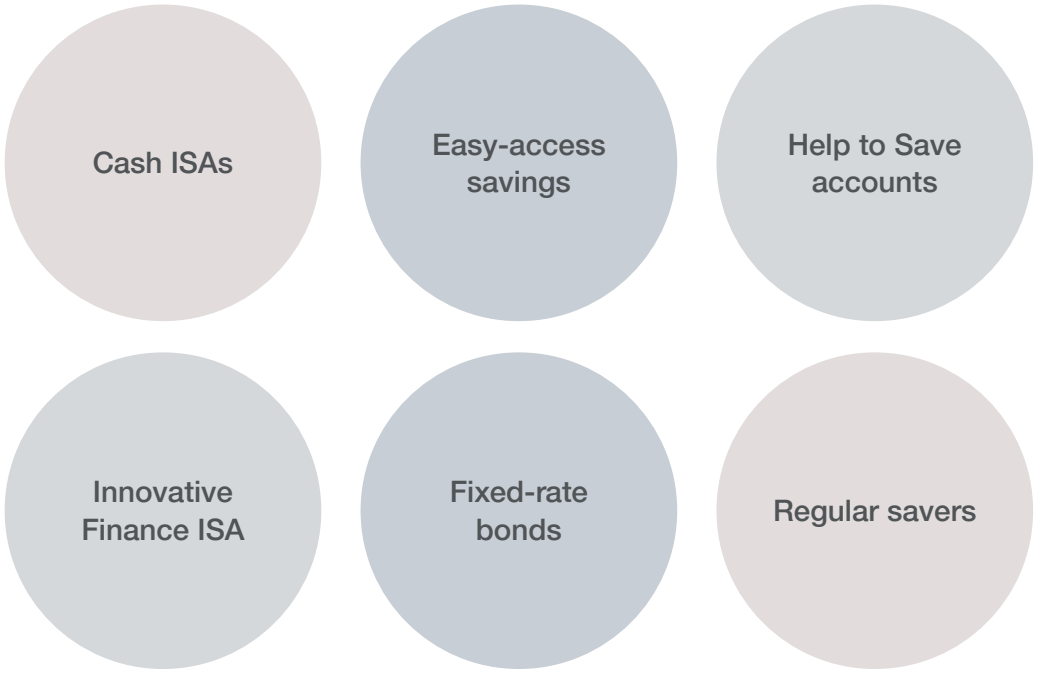
CONTENTS

Product case studies

Product: Savings accounts

Key Questions

1. Who is the target market and what are the use cases?
2. How will the savings account be marketed and sold?
3. Will you have a minimum or maximum savings amount?
4. Will the account permit third-party payments?
5. Will you offer the savings account directly or partner with a savings provider?
6. If you are the savings provider, how will you fund interest payments?



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Product: Savings account – Cash ISAs

Key product features

- Savings account
- Cash ISA:
  - scheme of investment
  - managed by ISA manager
  - consist of cash deposited in deposit account with GSIB
  - which is designated as an ISA account N.B. Flexible ISAs
- If the Cash ISA complies with ISA Regs, investors benefit from tax relief on income

Eligibility for Cash ISA

- Individual
- Aged 16 years plus
- UK tax resident
- Overall subscription limit GBP20K

Legal & regulatory considerations

- Savings account: Payment Services Regulations and Money Laundering Regulations
- Consumer protection legislation
- For cash ISA additionally note: Individual Savings Account Regulations 1998, N.B. rules concerning online contracting - application by individual under the ISA Regs may be made in writing, electronically or by telephone.
- FCA Handbook (PRIN, BCOBS, COBS)

Contractual considerations

- Cash ISA governed by agreement between ISA manager and investor. ISA manager's T&Cs should include:
  - investor holds beneficial ownership of amounts in Cash ISA;
  - terms on which investor may transfer or withdraw amounts from Cash ISA;
  - ISA manager will notify investor if, by reason of failure to comply with ISA Regs, Cash ISA does not benefit from tax relief.
- For savings accounts, more generally – note requirements in Payment Services Regulations and FCA Handbook.

CONTENTS

Product: Credit

Key Questions

1. **What credit, who is the target market and what are the use cases?**
2. **How will the credit be marketed and sold?**
3. **What is your fee/charging model?**
4. **Will you arrange insurance?**
5. **Which platform(s) will be used for operation of the lending business?**
6. **How will you fund the lending?**

FCA and regulated activities

Regulated credit activities are defined in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 and include:

- Entering into a regulated credit agreement as lender
- Exercising or having the right to exercise the lender's rights and duties under a regulated credit agreement
- Credit broking
- Debt adjusting
- Debt counselling
- Debt collecting
- Debt administration

It is a criminal offence to carry on regulated activities by way of business in the UK without authorisation unless exempt, and non-compliance with regulatory regime may render contract unenforceable.

Advertising

- Requirements in FCA Handbook CONC 3 for credit advert or other marketing material to be: eg clear, fair and not misleading, using plain and intelligible language
- Other requirements also apply including Treating Customers Fairly and the ASA requirements – N.B. FCA finalised guidance on the fair treatment of vulnerable customers (Feb 2021)
- Non-compliance can result in prosecution, regulatory action (including advertising ban), bad publicity/reputational damage and costs of withdrawing offending material (NB FCA latest quarterly figures on financial promotions April 2021)

CONTENTS

Product: Credit

What is credit? What is regulated credit?

– Credit Agreement is an agreement between an individual or "relevant recipient of credit" (A) and any other person (B), under which B provides A with credit of any amount

– "Regulated Credit Agreement" means a credit agreement which is not an exempt agreement.

– Exemptions - high net worth, business purpose, article 60F instalment credit etc.

– Woolard Review recommendations re article 60F exempt agreements

Key points to note and contractual considerations for regulated credit agreements

– Eligibility (section 50 of the Consumer Credit Act 1974)

– Section 176A CCA (electronic transmission of documents)

– Assessment of creditworthiness

– Adequate explanations

– Pre-contractual information detailing the prescribed requirements of the Consumer Credit (Disclosure of Information) Regulations 2010

– Prescribed drafting requirements for agreements set out in the Consumer Credit (Agreements) Regulations 2010

– Debtor must be provided with copy of executed agreement

– Right to withdraw

– Post-contractual statements and notices

– Early settlement rights

– Unfair relationships

– Unfair terms

NB – failure to comply with CCA requirements could result in the credit agreement being unenforceable, and in some cases, an inability to charge interest and other charges during any period of non-compliance

CONTENTS

Product: Cryptocurrency services

Key Questions

1. **Which cryptoassets will be available for purchase?**
2. **Will crypto activities be conducted through a separate entity?**
3. **Which crypto activities will be conducted eg advertising, issuance, exchange, wallet/custody or lending services?**
4. **What rights will be granted in relation to cryptoassets?**
5. **Will you have dependencies on third parties? What liability will you assume with respect to cryptoassets?**
6. **Will customers be able to make third-party purchases from merchants accepting cryptoassets as payment?**

Recent and upcoming UK regulation

Recent ban on retail crypto derivatives trading.

HM Treasury Jan 2021 consultation on regulation of cryptoassets and stabletokens.

- Licensing regime introduced for:
  - Single-fiat stabletokens, which shall be based on payments regime
  - Asset-linked stabletokens, with specific requirements on backing assets
- Unregulated tokens primarily used for speculative purposes (eg Bitcoin, Ether) will for time being remain outside regulatory perimeter for both conduct and prudential purposes.

Note. Narrower in scope than the EU Markets in Crypto Regulation (MICA).

Advertising

- HM Treasury proposing to expand the perimeter of the financial promotion regime to include certain unregulated cryptoassets, but only those that are **both fungible and transferable**.
  - Communications will fall within scope of the FP regime where they relate to the buying, selling, subscribing for or underwriting of qualifying cryptoassets.
  - Exemption for merchants accepting cryptoassets for sales of goods/services.
- Other requirements also apply including Treating Customers Fairly and the ASA requirements (see rule 14.1 and 14.4)
- Communicating a financial promotion in breach of section 21 is a criminal offence on the part of the unauthorised person under section 25 of FSMA. Authorised firms should obtain a specific permission from the FCA before undertaking approvals of financial promotions of unauthorised firms

CONTENTS

Product: Cryptocurrency services

Key product features

- App to upload or access fiat balance and purchase cryptocurrency
- Crypto payment acceptance
- Product impact of relationship with third-party exchange and wallet provider
- Multi-jurisdictional considerations
- Issuance of cryptoassets eg stablecoin?
- Lending in and/or secured on cryptoassets?

Licensing considerations

- Certain activities already covered by banking licence?
- If establishing new entity for this business line:
  - Possible future licensing under future UK or, if applicable, EU regimes

N.B. Other international regulatory licensing proposals

Legal & regulatory considerations

- Nature of cryptoassets: exchange tokens, e-money (or deposit) tokens, utility tokens or security tokens?
- Regulated activity under FSMA/MiFID II?
- Regulated lending?
- Capital impact of holding cryptoassets
- Registration under AML regime for exchange/custody services
- Proposed extension of UK financial promotions regime
- Prohibition on retail crypto derivatives trading

Contractual considerations

- User agreement between company and customer
- Nature of the customer's ownership interest in underlying cryptoasset
- Liability of crypto service provider
- Custody of underlying cryptocurrency

CONTENTS

Product design and oversight

Product design – key principles and considerations

Target market	Value for money and meeting customer needs	Client communications and understanding
Stress testing	Impact on risk profile	Vulnerable customers
Distribution channels	Third-party providers	Regulatory

CONTENTS

Retail Product Provider/Distributor Responsibilities

FCA guidance – *The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD)*

Provider Responsibilities

Product design	– Identify target market – types of customer for which the product or service is suitable (or not suitable) – Stress-test – identify how product might perform in a range of market environments and how the customer could be affected – Systems and controls to manage risks posed by product or service design

Information to distributors and customers	– **Providing information to distributors:** make clear if information is not intended for customer use, and consider whether distributors will understand it enough to give suitable advice (where advice is given) and to extract any relevant information and communicate it to the end customer.
	– **Providing information to customers:**
	  – Consider customer's level of financial capability
	  – What information the customer needs to understand the purpose and the risks of a product
	  – Be clear, fair and not misleading
	  – Systems and controls to manage risks posed by providing information to customers

Distribution	– Decide whether this is a product where customers should seek advice – Review how what is occurring in practice corresponds to (or deviates from) what was originally planned or envisaged for the distribution of products – Act on concerns – eg by ceasing to use a particular distribution channel
Post-sale responsibility	– Periodically review products to check whether the product is continuing to meet the general needs of the target audience that it was designed for – Communicate to the customer contractual 'breakpoints' – Act fairly and promptly when handling claims – Effective and transparent customer complaint-handling systems

Distributor Responsibilities

Financial promotions	– Systems and controls to manage the risks of financial promotions – Act with due skill, care and diligence. A firm will not contravene the financial promotions rules where it communicates a promotion produced by another person provided the firm takes reasonable care to establish that another firm has confirmed compliance with the relevant detailed rules, amongst other matters
Providing information at point of sale to customer	– Consider, when passing provider materials to customers, whether it understands the information provided – Ask the provider to supply additional information or training where that seems necessary to understand the product or service adequately – Do not distribute the product or service if it does not understand it sufficiently, especially if it intends to provide advice
Advising on the selection of a provider	– Consider the nature of the products or services offered by the provider and how they fit with the customer's needs and risk appetite – Consider what impact the selection of a given provider could have on the customer – eg charges; financial strength of the provider; how reliably the provider will deal with the distributor or customer
Post-sale responsibility	– Comply with any contractual obligation it has to the customer, for example to provide ongoing advice or periodic reviews – Consider any implied or express representation it made (during meetings, correspondence or promotional material, for example) – Effective and transparent customer complaint-handling systems – Pass any relevant communications received from customers to providers in a timely and accurate way

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Third-party oversight

Third-party Product Providers

Firms may use third-party product providers as part of 'wrapped' or 'packaged' products

In such cases, it is key to ensure third parties are meeting relevant requirements

Oversight of these arrangements should form part of the broader outsourcing framework

Outsourcing Framework

Strategy

- Outsourcing strategic approach
- Critical or important function criteria
- Alignment to recovery and resolution plan
- Operational continuity in resolution of critical functions

Governance

- Board/Management body oversight
- Reporting – frequency, accuracy, coverage
- Risk appetite (inc. concentration, intra-group)

Framework

- Outsourcing framework and policy
- Roles and responsibilities
- Supervisory conditions
- Conflict of interests

Due Diligence

- Pre Outsourcing due diligence
- Risk assessment sub-outsourcing
- Data and systems security verification
- Contractual requirement definition
- Values alignment

Management

- Day to day management
- Risk and performance monitoring
- Access, information and audit rights
- Financial strength monitoring
- BCP testing

Exit

- Termination rights, criteria and approach
- Transfer and re-integration capability and execution

Documentation

- Outsourcing register
- Regulatory reporting
- Contracts
- BCP and exit plans

CONTENTS

Pre-launch – process and governance

This page sets out a high-level new product approval process, up to the stage of product launch

Governance

- Effective governance and oversight over NPA process, including decision-making and sign-offs, clear NPA policies and procedures, clearly defined individual roles, responsibilities and accountabilities
- Oversight and review from risk management, including risk assessment of new products and their impact on firm risk profile
- Robust and effective controls

CONTENTS

Post-launch – ongoing review

This page sets out ongoing considerations post-launch

Performance

- Product performance should be monitored and tested
- Appropriate MI and controls

Customers

- Firms should monitor whether product is meeting target customers needs as expected, and how vulnerable customers are impacted and treated
- Handle customer relations fairly on ongoing basis

Governance

- Have in place governance around periodic reviews, including reporting to relevant committees and oversight over implementation of any actions arising

High-risk products

- Certain high-risk products may be subject to heightened processes and controls, eg product 'MOTs' at senior committees

Risk and controls

- Monitor the impact of the product on the firm's risk profile, eg whether it remains in line with risk appetite and strategy as expected

Amendment conditions/ process

- Consider conditions and thresholds for amending or ceasing a product
- For example, whether certain changes to a product constitute a 'new' product, how this is approved and communicated to clients, etc

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Session 8

CONTENTS

Standing on the summit: ensuring growth is sustainable

Agenda

1. Acquisitions/control transactions
2. Acquihires
3. Corporate venturing and minority investing
4. Joint venture and commercial collaborations
5. Incubators and accelerators
6. Organic growth

Presenters

Will Samengo-Turner
Partner

Kate Sumpter
Partner

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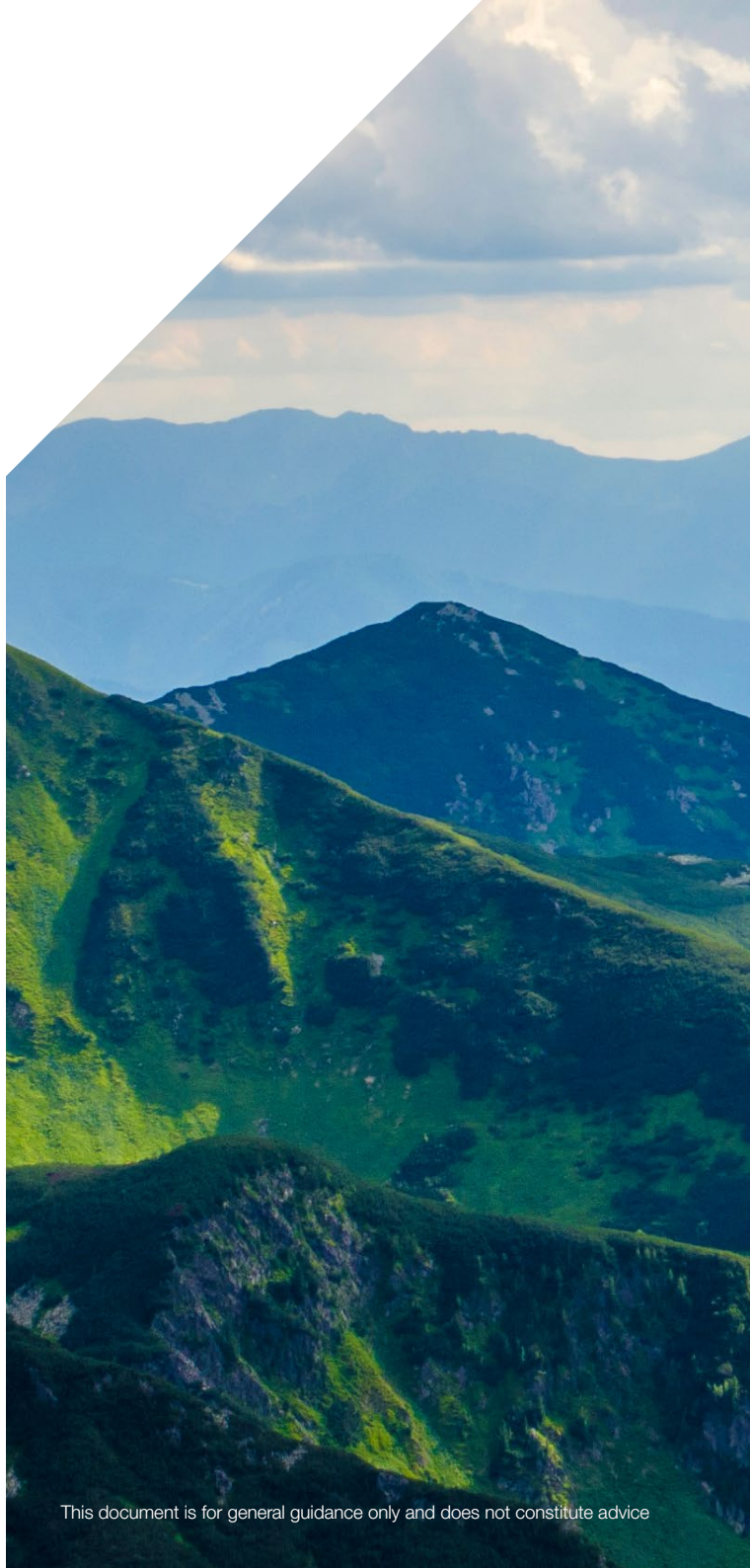
Partner



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Organic growth

What?

Apply funds raised through traditional equity and debt sources to grow the business organically.

Why?

Avoiding an "event driven" growth strategy with full control over the time, scale and scope of growth plans.

Pros

- Maintains culture of the business
- High degree of control over growth plans
- Easier to plan and scope out opportunities
- Maintains focus on clearly set objectives
- Generally less costly
- No inherent antitrust concerns
- Unless new products are proposed, or there is a significant change in strategy, won't require high touch regulatory engagement

Cons

- Generally slower – competitors deploying different strategies may leapfrog you
- May miss out on opportunities elsewhere in the market
- Lacks the creative disruption of interacting with other businesses
- May be seen as less ambitious by investors
- May be expensive, particularly if there is a disconnect between raising funding and deployment into assets

Incubators and accelerators

What?

A group of start-ups is selected to participate in a limited-time program run by the company focussing on innovation/concept development (in the case of incubators) and growth acceleration (in the case of accelerators).

Why?

Avoiding an "event driven" growth strategy with full control over the time, scale and scope of growth plans.

Pros

- Access to creative thinkers and new talent
- Limited financial investment (seed financing, if any)
- Limited duration (4-18 months)
- Broad focus on different ideas
- Often has a positive effect on the institutions brand

Cons

- Limited control over innovation assets and the direction of travel of the start-ups
- Start-up can eventually sell out to competitors
- Can be difficult to differentiate given so many are in the market
- Requires consideration of how innovation assets might be deployed – eg does this require an outsourcing?

CONTENTS

Joint venture and commercial collaborations

What?

Two or more parties work together through an incorporated entity or on a contractual basis.

Why?

The organisation can team up with other parties to develop a technology, product or business particularly where the respective parties each bring key skills/assets to the table.

Pros

- Share innovation/combine technologies
- Expansion from established business lines
- Risk sharing and cost savings
- Useful in particular circumstances – ie where one party brings IP and the other brings commercialisation

Cons

- Complexity of establishment and decision-making
- Slow and delicate implementation
- May require merger clearance and possible increase in regulatory burden (eg will the JV be consolidated; will V staff be subject to bank remuneration requirements)
- May create antitrust risk (eg JV partner)
- High rate of failure
- Contractual route needs to be considered against regulatory outsourcing requirements

Corporate venturing and minority investing

What?

Corporate/strategic parties take a minority stake (generally sub-20%) in a fast growing start up. The investment is generally made on market stranded VC terms.

Why?

Established businesses are increasingly driven by the need for innovation and a desire to harness the dynamism of new market entrants. The target usually retains flexibility to work with other institutions.

Pros

- Lower risk/less capital required
- Flexibility as to how close an institution wishes to be to the target.
- Numerous exit strategies
- Access to talent
- May also stimulate demand for the institutions own products
- Minority stakes (sub-20%) will have limited capital impact

Cons

- Aligning expectations around investment runway is critical.
- The length of the investment runway is a particular consideration in R&D intensive projects which may require significant investment before they turn cash positive.
- May require merger clearance and antitrust authorities currently laser focused on 'killer acquisitions' in the tech space

CONTENTS

Acquihires

What?

An acquisition of a corporate entity for the sole purposes of hiring the employees (business wound down after purchase).

Why?

Where a company is at a relatively early stage and has yet to gain momentum but has an impressive team which would work well with the acquirer's business.

Pros

- Relatively simple compared to traditional M&A
- Allows for substantial increase of team or acquisition of key talent (particularly engineers)
- Consideration of product/customer integration is not relevant – it is all about the people

Cons

- Given a business is being acquired, their tail liability is still an issue – full DD is required
- Requirement to consider wind down of acquired business and existing customer/supplier relationships
- Can become complicated if only a limited number of team members are desired
- Will require engagement with regulators and, depending on the nature of the target, may require regulatory approvals

Acquisitions/control transactions

What?

A wholesale acquisition of another business.

Why?

Allows for complete integration and, if managed properly, the development of a new talent base within the acquirer.

Pros

- More control over innovation
- More due diligence and certainty of understanding of the risks
- Technology may already be developed and ready to integrate into your business

Cons

- More complex governance of relationship with the founders on an ongoing basis
- May require merger clearance
- Difficult to fix the right valuation and pricing mechanics with early stage companies
- Can be more costly
- If the asset proves to be unsuccessful an exit is much harder
- Will require engagement with regulators and, depending on the nature of the target, may require regulatory approvals

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Drivers and regulatory considerations

PRA Notifications Rule 2.3: A firm must give notice of… any proposed restructuring, reorganisation or business expansion which could have a significant impact on the firm's risk profile or resources.

	Driver	Considerations
Access to international markets	– New markets and customer bases – Client demand for an international offering	– Licenses/authorisations – Legal and compliance complexity
Funding	– Cost	– Sustainability – Scope to deploy funding in profitable assets
New products or services	– Customer demand – Scope for complimentary product offerings – Innovation	– Compliance complexity – Risks associated with the product or service – Fit with 'brand' – Staff expertise – Required funding/capital
Scale	– Desire to defray existing (fixed) costs	– Appropriateness of marketing/customer onboarding – ICAAP meets minimum standards and is fit for purpose

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Session 9

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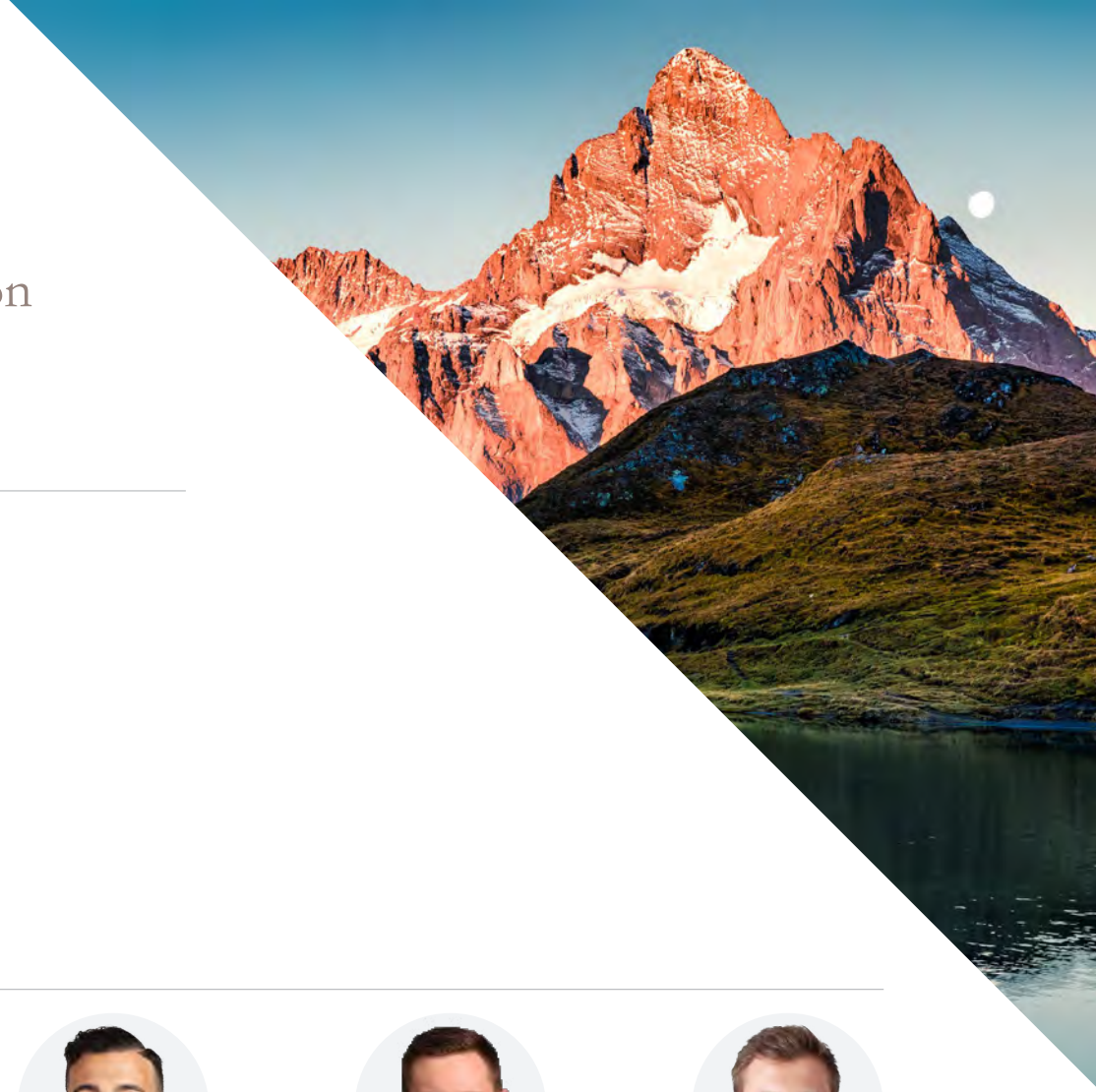
Mountain rescue:
pre-empting and avoiding the key litigation and regulatory pitfalls



Agenda

1. Culture, governance and individual accountability
2. Treatment of retail customers
3. Operational resilience, outsourcing and cyber security
4. Financial crime
5. Key risks on the horizon
6. Litigation risks: privilege and class/group litigation

Presenters

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Nicholas Gomes
Senior Associate

Aaron Jones
Associate

David Siesage
Associate

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Setting the scene

The enforcement appetites of the FCA and the PRA show no sign of waning

The FCA
576 open enforcement investigations

▲ 80% since 2015/16

The PRA
26 open enforcement investigations

▲ 12% since 2018

Sources: FCA and PRA websites and Annual Reports | As at October 2020

There are a number of common themes and topics that feature in FCA final notices issued to firms (mainly banks) in the last three years

36% of final notices involved **Skilled Person Reviews**.

64% of final notices referred to **internal audit findings**.

24% of final notices made findings relating to **outsourcing** arrangements.

68% of final notices included failings in relation to firms' **systems and controls**.

24% of final notices included findings about **attitudes towards compliance**.

56% of final notices highlighted weaknesses in firms' **governance** arrangements.

48% of final notices referred to weaknesses in **senior management oversight**.

44% of final notices identified deficiencies in relation to firm's **training** programmes.

Sources: FCA Final Notices issued to firms (excluding Threshold Condition cases) between 2018 and October 2020 | Allen & Overy research

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Culture, governance and individual accountability

The FCA has identified four key drivers of culture within firms

- Purpose
- Leadership
- Governance
- Reward and management

"Culture can be defined as the habitual mindsets and behaviours that characterise an organisation."

Source: FCA Mission: Approach to Supervision (April 2019) | FCA 'Messages from the Engine Room' 5 Conduct Questions Industry Feedback for 2019/20 Wholesale Banking Supervision (September 2020)

60% of FCA final notices in the last three years included findings relating to culture, governance and/or senior management oversight

- Lack of understanding or appreciation by senior management about the **regulatory environment**.
- Lack of formal governance in relation to senior management **sign-off** as part of certain processes.
- Lack of senior management oversight in relation to **conduct risk controls**.
- Individuals failing to **understand governance arrangements** and their roles in them.
- Inadequate governance arrangements put in place to manage **specific projects**.
- Inadequate **challenge and/or scrutiny** of issues and/or decisions by senior management.
- Inadequate governance arrangements for senior management to **properly oversee the business**.
- Inadequate governance arrangements to oversee **outsourcing arrangements**.

Source: FCA Final Notices | Allen & Overy research

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Enforcement lessons learned for challenger banks going through periods of rapid growth and/or business expansion

"This case concerns a serious failure in [the firm's] corporate governance and control arrangements which resulted in it being poorly organised and managed across its business as a whole following a decision to expand and diversify into a new business area, by writing business for European clients through three branches across Europe… the corporate governance at [the firm] and the mix of skills and experience of the directors and senior management failed to change sufficiently quickly to reflect the expansion of the business into a new area."

"[The firm] pursued an aggressive growth strategy, with a specific focus on high-risk, sub-investment grade lending. [A business area] did so despite known weaknesses in the control framework, which meant that it failed to provide robust oversight and challenge to the business… The firm did not take reasonable steps to assess, manage or mitigate the risks involved in the aggressive growth strategy."

Source: FSA Final Notices issued to Mitsui Sumitomo Insurance Company (Europe) Ltd (2012) and Bank of Scotland Plc (2012) | Allen & Overy research

CONTENTS

Investigations into individuals represent 60% of the FCA's and 65% of the PRA's current enforcement caseload

349 individuals under investigation by the FCA

45 Conduct Rules Staff under investigation by the FCA

21 Senior Managers under investigation by the FCA

17 individuals under investigation by the PRA

12 Certified Persons under investigation by the FCA

Source: Freedom of Information Act Request submitted to the FCA & Allen & Overy research | PRA Annual Report 2019/20

The FCA's strong focus on non-financial misconduct continues

"Poor culture in financial services can lead directly to harm to consumers, market participants, employees and markets. It was a key root cause of recent major conduct failings within the industry. How a firm handles non-financial misconduct throughout the organisation, including discrimination, harassment, victimisation and bullying, is indicative of a firm's culture. We view both lack of diversity and inclusion, and non-financial misconduct as obstacles to creating an environment in which it is safe to speak up, the best talent is retained, the best business choices are made, and the best risk decisions are taken."

FCA 'Dear CEO' letter to general insurance firms, January 2020

CONTENTS

The FCA's focus on 'non-financial misconduct' has extended well beyond sexual misconduct

Sources: Various FCA publications and speeches

CONTENTS

Diversity and inclusion: A sixth conduct question on the horizon?

"As part of our work on wholesale banking culture, we introduced 5 conduct questions to help focus minds of senior managers on conduct risk. I would like to see this expanded – and a sixth added – for all firms: is your management team diverse enough to provide adequate challenge and do you create the right environment in which people of all backgrounds can speak up? This is much broader than representation. It is about a firm's culture. Not just in relation to diversity, but inclusion, too. Do people feel comfortable in the work environment such that they can demonstrate, share and bring to bear their diversity of experience and background?"

Speech by Nikhil Rathi, FCA Chief Executive (March 2021)

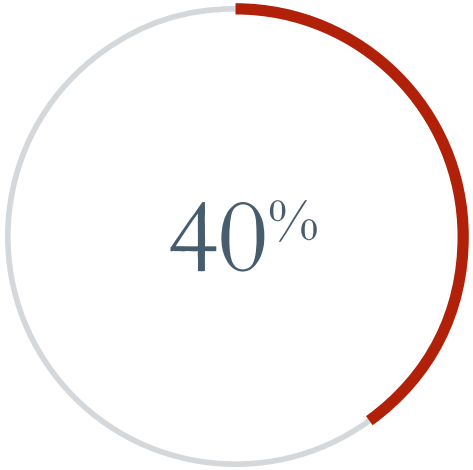
Key areas of focus for the FCA and the PRA in relation to firms' approaches to whistleblowing

- Identifying whistleblowing disclosures
- Dealing with whistleblowing disclosures appropriately
- Safeguarding against potential retaliation and victimisation

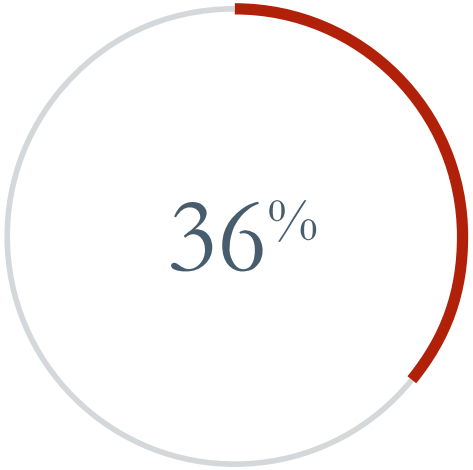
CONTENTS

Treatment of retail customers

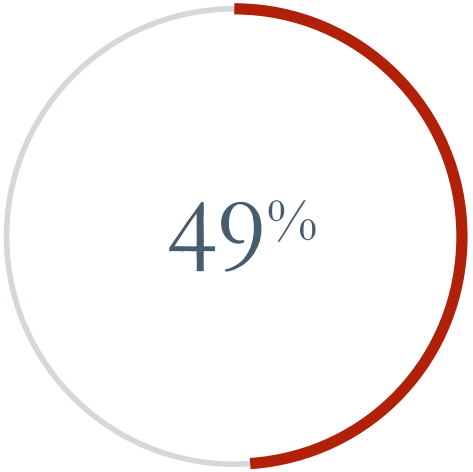
Taking enforcement action in relation to retail issues and conduct remains a key priority for the FCA



of FCA final notices since 2018 include findings relating to TCF and/or customer communications.



of open FCA enforcement cases concern retail conduct.



of financial penalties imposed by the FCA in 2020 so far relate to retail conduct.

in customer redress paid by eight firms in connection with FCA enforcement action since 2018.

Sources: FCA Final Notices issued to firms (excluding Threshold Condition cases) between 2018 and October 2020 | Allen & Overy research | FCA Annual Report 2019/20

CONTENTS

Key issues that have been identified in recent FCA final notices relating to retail conduct

Adequacy of documentation used by customer-facing employees (eg guidance notes, scripts, Q&A documents) and monitoring whether employees use it appropriately.

Quality and frequency of training provided to customer-facing employees about how they should interact with customers.

Particular focus on the treatment of vulnerable customers or customers who are in financial difficulties, especially in light of new FCA guidance.

Identifying the risk of unfair treatment of customers, even if that risk has not/ does not crystallise.

Deficiencies in firms' systems and controls to handle customer complaints, as well as their handling of specific customer complaints.

Sources: Various FCA Final Notices

CONTENTS

The new Chief Executive of the FCA has identified proactively identifying and tackling consumer harm as key priorities for the FCA

"To your point on preventing consumer harms, I would pick up two points. First, I talked about data and analytics and being able to sensitise supervisors to what is going on regarding the risks and getting to them quickly. Secondly, given the split between large firms and small firms, I want to make sure that the best people also want to work on supervising the small firms and not just the big firms. I think that is going to be quite important as well - making that a very high-priority, high-profile part of the work that the FCA does."

"I would certainly like you to see results in the area, for example, of financial promotions. I imagine, particularly if the new powers come through, that we will be more interventionist. I would want to see the data analytics strategy working in a way that enables us to prevent things from happening. That is something that I look forward to talking to the Committee about in the coming years."

Source: Nikhil Rathi, Oral Evidence to the Treasury Select Committee (22 July 2020)

CONTENTS

Civil Claims

Claims about advice or suitability

– Breach of contract
– Negligent advice
  – Was advice in fact given?
  – Was advice given in circumstances giving rise to a duty?

False or misleading statements

– Misrepresentation Act 1967
– Negligent misstatement
– Deceit
– Implied representation

Retail

– Claims for a breach of statutory duty under s.138D FSMA
– Complaints to the FOS

Practical lessons

1. **Reliance on adverse regulatory findings/investigation materials**
2. **Consider contagion risk**
3. **Balancing customer relationship with legal risk**
4. **Relevance of regulatory obligations and internal policies**
5. **Importance of documentary evidence (vs lack of witnesses)**
6. **Avoiding creation of unhelpful documents after issues arise**
7. **Contractual terms can give you significant protection – take care with your drafting…**

CONTENTS

Drafting Considerations

1. **Consider overall contractual framework (particularly where there may be overlapping agreements)**
2. **Disclaimers in presentations, term sheets etc.**
3. **– Contractual representations/warranties/covenants as to:**
   - **Execution only; not acting as adviser or fiduciary**
   - **Independent decision acting upon independent advice**
   - **Not relying on any communication as investment advice/recommendation**
   - **No representation or warranty on accuracy of information provided**
   - **Understanding and assessment**
   - **Capacity and authority**
4. **Entire agreement clause**
5. **No oral modification clause**
6. **General limitation of liability**
7. **Note statutory controls**

CONTENTS

The Financial Ombudsman Service applies a different standard to courts, but will have regard to the FCA Principles for Businesses

"A complaint is to be determined by [the FOS] with reference to what is, in the opinion of the ombudsman, fair and reasonable in all the circumstances of the case."

Section 228(2) FSMA

"… it is my view that it would be a breach of statutory duty for the [FOS] to reach a view on a case without taking the [FCA's] Principles into account in deciding what would be fair and reasonable and what redress to afford…"

R (British Bankers Association) v FSA [2011] EWHC 999 (Admin) para. 77

Operational resilience, outsourcing and cyber security

Operational resilience, outsourcing and cyber security are key areas of focus for the FCA and the PRA

Focus areas

Covid-19: ongoing challenges

FCA Annual Report: *"Operational resilience has become even more important during the current pandemic, both so that services to businesses and consumers can continue and for the majority of firms' staff working from home".*

New rules for banks

New requirements for banks to identify their important business services, set a tolerance for disruption and take steps to ensure they can continue to deliver their important business services during severe but plausible scenarios.

Identified risk areas

Change management: Single greatest cause of technology incidents reported to FCA.

Third-party services: Root cause of 16% of operational resilience incidents in 2019/2020.

Cyber attacks and ethical hacking

The FCA and the PRA intend to test the cyber resilience of 88 firms over a five year period. Individual and industry-wide feedback will be provided.

CONTENTS

Sufficient responsiveness to Covid-19 does not mean firms should regard themselves as fully operationally resilient

"Overall the finance sector's response to Covid-19 is a relatively good news story. However, there is a real danger now that the pandemic is seen as an extreme test of operational resilience that proves that the financial sector is already operationally resilient. **Does this mean "job done"? We don't think so.** There are characteristics of this event, extreme as it is, which made it easier for us all…

There are threats out there that will not be slow, prolonged and symmetric but precisely the opposite, fast, short-lived and asymmetric. Cyber is one such example but idiosyncratic operational failures or key third-party failures will be fast, short-lived and asymmetric. Incidents with these characteristics, fast, short-lived and asymmetric, may rely on some of the same response and recovery capabilities but **they will test an organisation's preparedness to the limit and in potentially different ways from that which Covid-19 has**. As firms rapidly changed their way of working to deliver their important business services, they have faced a changed operating environment and heightening of risks."

Source: Bank of England speech 'Resilience in a time of uncertainty' by Nick Strange, Senior Technical Advisor, Supervisory Risk Specialist (October 2020)

CONTENTS

Cyber/data breach strategy – three crucial aspects

Prevention and preparation

- Threat analysis
- Policies
- Practices and training
- Third-party contracts
- Insurance
- Response plan: test and practice

Dealing with a breach

- Immediate priorities
- Reporting obligations
- Optional reporting eg police
- Potential civil legal remedies
- Comms and PR

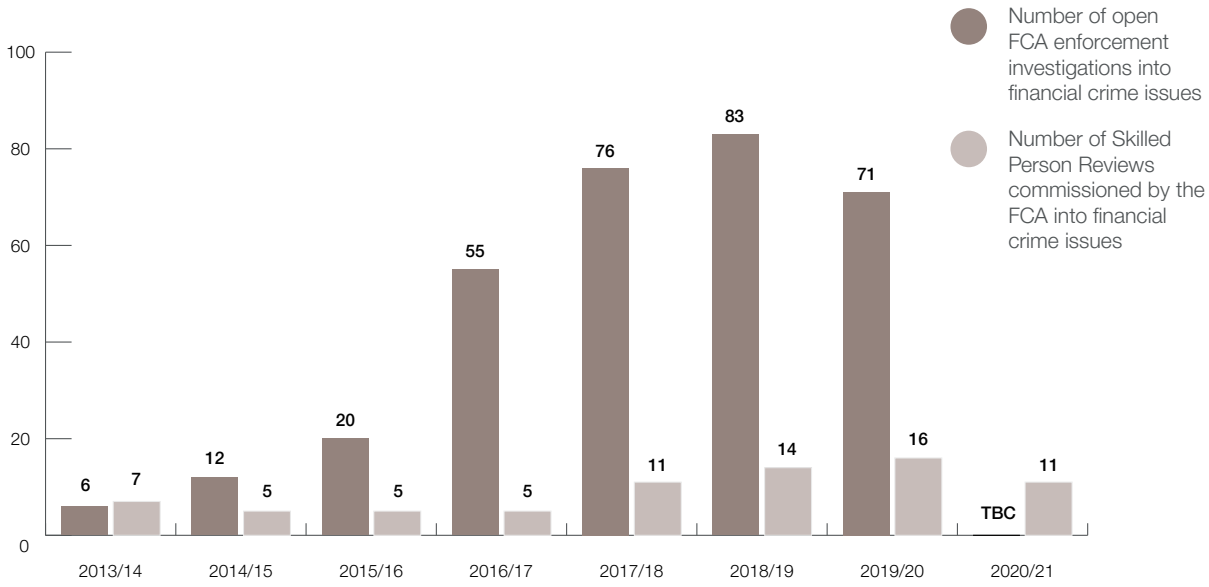
Post-breach actions

- Ongoing regulatory investigations/actions
- Manage litigation risk
- Ongoing comms and PR
- Employee training/ disciplinary measures
- Refine/supplement policies and procedures

CONTENTS

Financial crime

The FCA's ongoing focus on financial crime is reflected in its open investigations and Skilled Person Reviews, despite levelling off

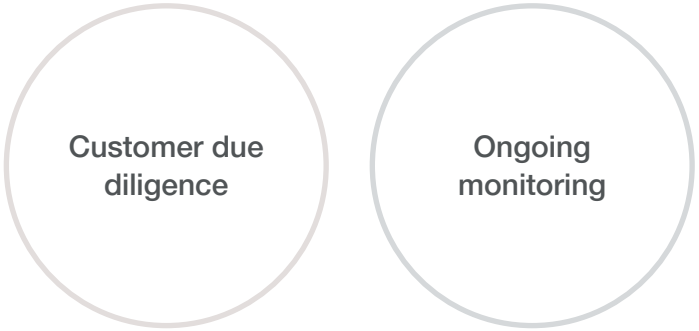


Sources: FCA Annual Reports | FCA website

Consistent with the general fall in investigations, the number of open financial crime investigations decreased by 14% in 2019/20, although there is still evidence of growth on a longer horizon.

Notwithstanding the plateau in open investigations, the number of Skilled Person Reviews commissioned by the FCA into financial crime issues has continued to increase, remaining the most popular topic for Skilled Person Reviews.

Key areas of focus for the FCA's regulatory and criminal money laundering investigations



CONTENTS

Privilege

Understanding the rules on disclosure and privilege can help businesses manage risk

Parties often face disclosure obligations in civil, regulatory or criminal proceedings

Cases can turn on damaging documents

Obligations differ between (and within) jurisdictions

Privilege may allow you to avoid disclosure, but rules can be counter-intuitive

Understanding the rules and creating and sharing documents in a controlled way can help control risks

CONTENTS

Key heads of privilege in English law

Legal advice privilege

protects **confidential communications** between a **lawyer and a client** for the **dominant purpose of giving or receiving legal advice in a relevant legal context**, as well as documents evidencing such communications

Litigation privilege

protects **confidential communications** between **lawyers or their clients and third parties** made for the sole or **dominant purpose** of obtaining information or advice in connection with the **conduct of litigation which is in progress or in reasonable contemplation**

Some thorny privilege issues

Narrow concept of 'client' for legal advice privilege

The 'dominant purpose' test

When is litigation 'in reasonable contemplation'?

CONTENTS

Class/group actions

Types of class/group procedure

Representative action
CPR r19.6

Lloyd v Google (data breach)
Emerald v BA (air freight)

Group litigation order
CPR r19.11

RBS (shareholders/rights issue)
VW (diesel emissions)
Berkeley Burke (pension holders)
Lloyds/HBOS (shareholders)
Morrisons (data breach) [refused]

Competition collective proceedings
s47B CA98

Merricks (cred/debit card fees)
Trucks
O'Higgins/Evans (FX trading)
Gutmann (train fares)
BT (landline phones)
Qualcomm (phone chipsets)

Test cases

OFT v Abbey Nat. (bank charges)
Business interruption insurance

Key issues and drivers

– Common issues (of fact or law)

– Opt-in vs Opt-out

– Certification/permission

– Litigation funding and ATE insurance

– US-style claimant law firms/claim managers

– Proof of causation and loss on class-wide basis

CONTENTS

Key risks on the horizon

What litigation and regulatory risks are on the horizon?

Financial resilience and the preservation of client assets and money	Continued focus on the treatment of vulnerable retail customers and customers in debt/arrears	Insolvency/business failures	Group/class litigation
Claims arising from data breaches and cyber security failures	Covid/lockdown-related litigation	Increased and different conduct risks associated with employees working remotely	Financial pressures causing firms to 'cut corners' on governance and systems and controls

CONTENTS

Session 10

CONTENTS

Your climbing partners:
what to expect of your external advisors

Agenda

1. Introduction
2. Advanced Delivery & Solutions
3. The Allen & Overy global legal innovation benchmarking report
4. Introduction to Fuse

Presenters

Angela Clist
Partner, Head of LSC

Jonathan Brayne
Partner, Chair of Fuse

Shruti Ajitsaria
Partner, Head of Fuse

Tom Balogh
Executive Director,
A&O Consulting

Jessica Hamilton
Senior Client Development Manager,
Peerpoint

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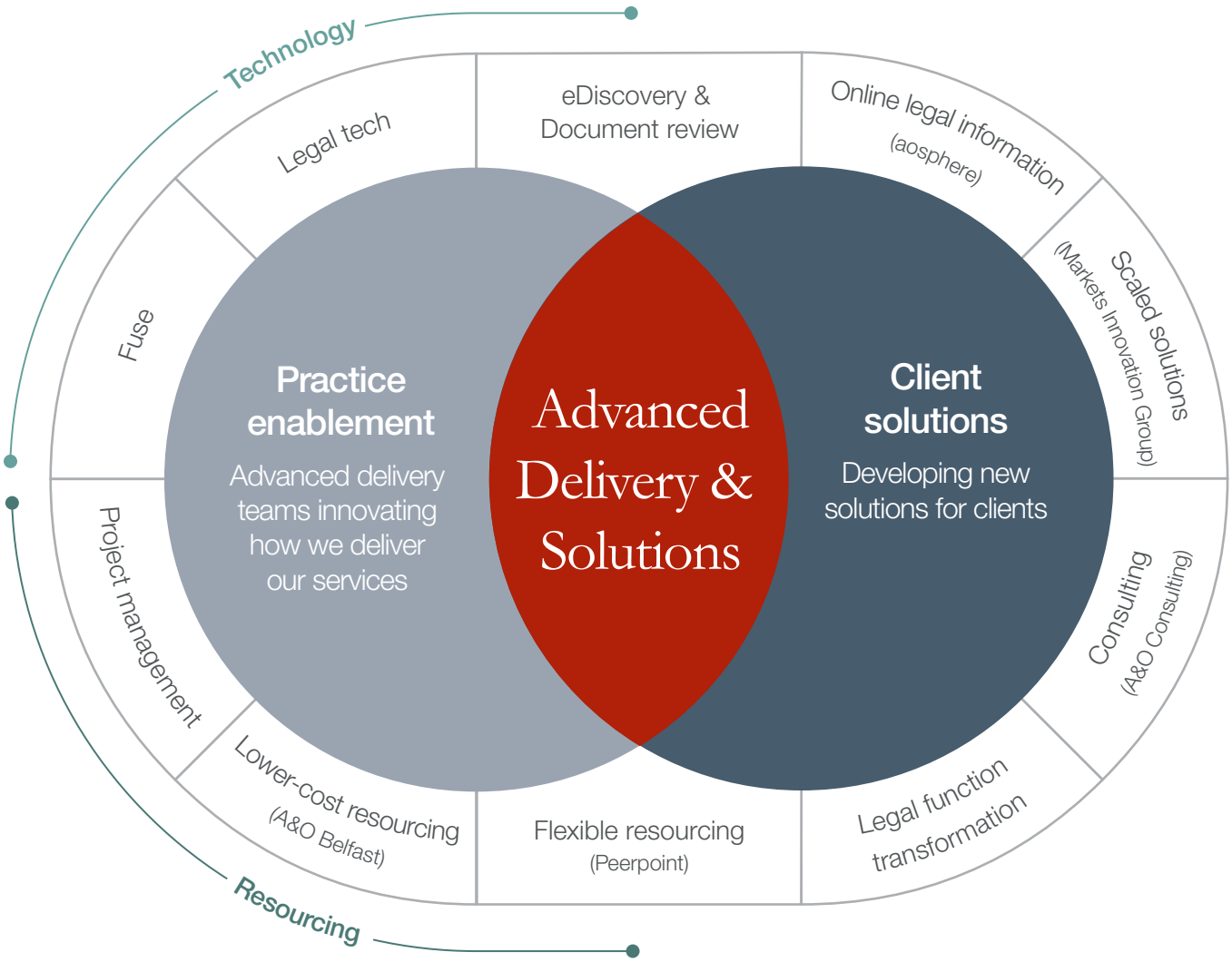
Advanced Delivery & Solutions



CONTENTS

AD&S case studies

A&O Belfast

- For one of our banking clients, preparing drafts and reviewing corporate loan agreements (under the supervision of the London team). This results in a cost saving of at least 35% from standard rates.
- For a corporate start help, helping with equity funding documents.
- For various asset managers, providing corporate secretarial support (board mins, etc).

A&O Consulting

Business integrity by
ALLEN & OVERY

- **Culture assessment:** through document review, 1:1 interviews with senior leaders and workshops with a cross-section of firm employees, we reported to the board and executive committee on the culture of the firm and recommended actions to be taken.
- **Board and Governance Review:** to support the client's forthcoming application for banking regulatory licence.
- **Ongoing Regulatory Support:** provided ongoing advice to the firm in respect of its regulatory interactions and priorities, including how to meet growing regulatory expectations, and assisted senior management to prepare for meetings with regulators.

Peerpoint.

by ALLEN & OVERY

- Interim Head of Legal to a challenger bank reporting to the COO (prior to the appointment of the GC).
- Specialist legal talent to a large payment company. (Provided three employment specialists.)
- Senior commercial and compliance coverage for a Fintech on a flexible arrangement.
- Additional coverage for a Fintech providing various legal specialists in periods of growth.
- Regulatory change strategic delivery and implementation providing senior lawyers or small teams.

CONTENTS

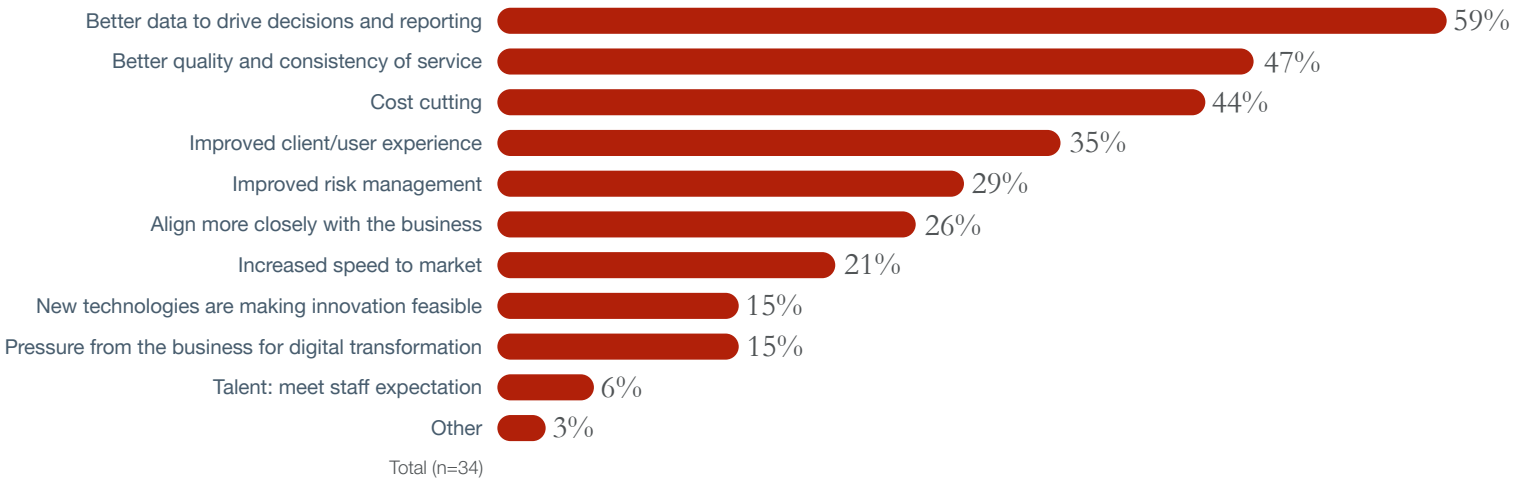
The Allen & Overy global legal innovation benchmarking report

Headline findings

- Participants understand the drivers and barriers to innovation
- They have ambitious aspirations to change
- But there is a gap between those aspirations and their adoption of the new approaches needed for practical implementation
- The participants enjoying the most success from innovation are more ready to adopt those new approaches
- Few participants have comprehensively transformed their legal function

Better data is the key driver of innovation

Please rank the following in terms of their importance as drivers of innovation in your part of the legal function…



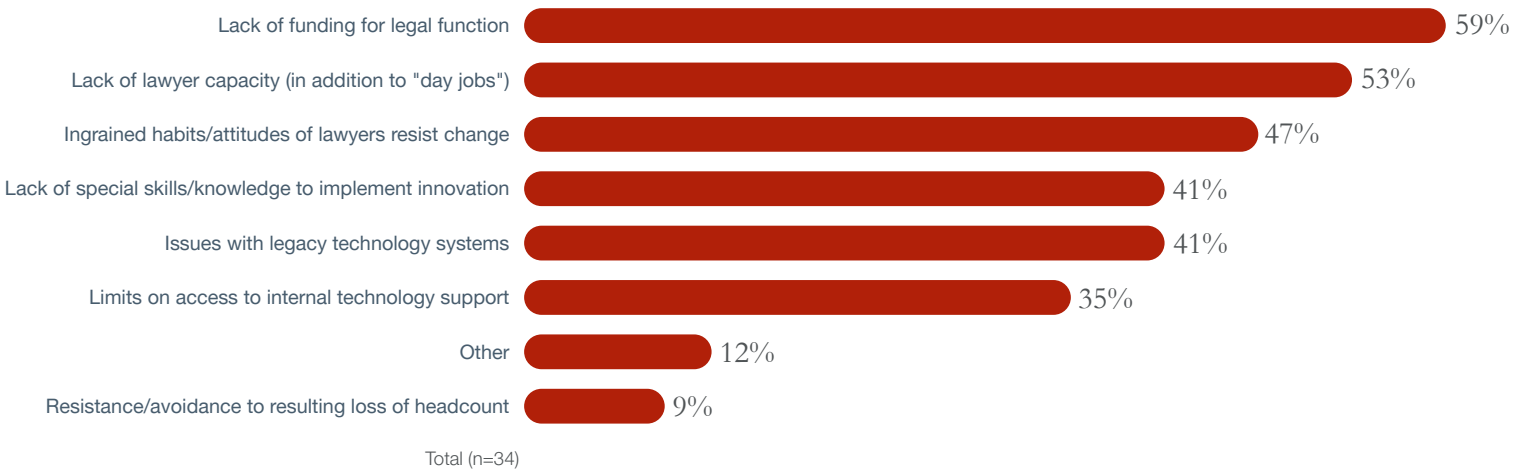
- Followed by the need to deliver a better service
- Surprising that cost cutting is third (ie not higher)

CONTENTS

Filters applied: Industry Banking **Regulated status**: Regulated banks
Participant email address: No selection **Time periods**: 2019-11-18 - 2020-04-01

Lack of funding is the primary barrier to innovation for banks

Please rank the following in terms of their importance as barriers to innovation in your part of the legal function…



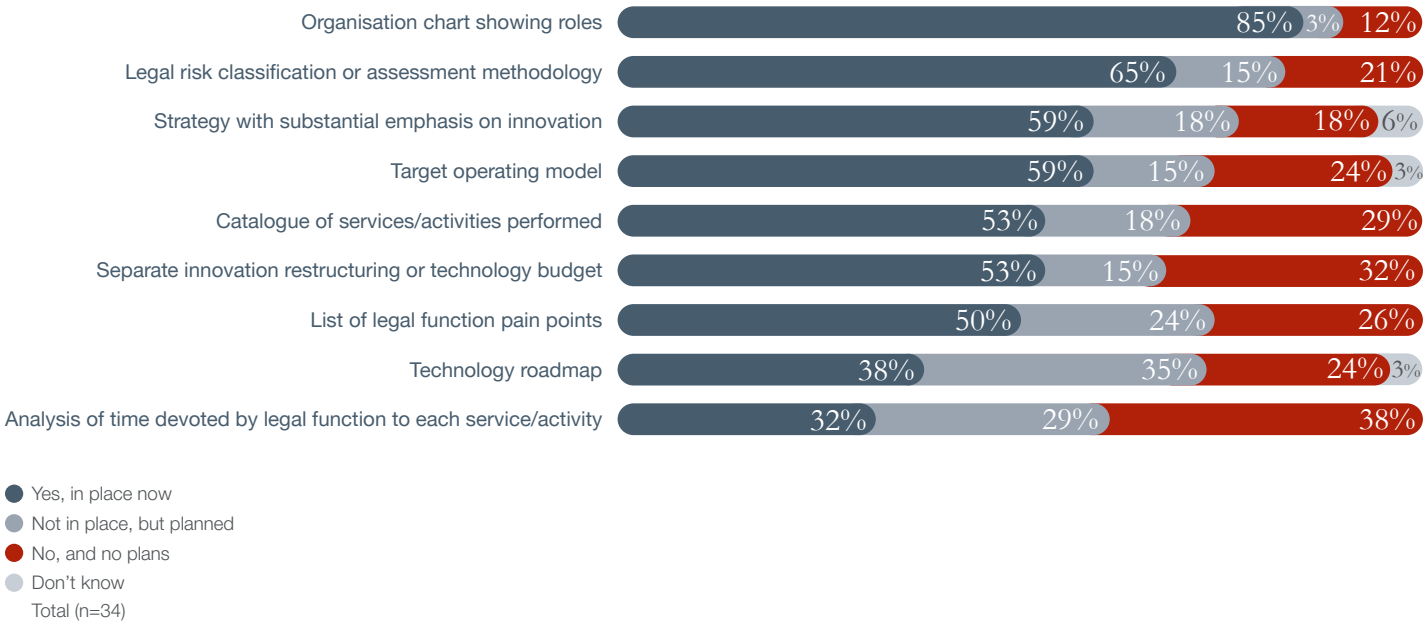
- But talent issues are a close second
- Tech challenges are well down the list

CONTENTS

Filters applied: Industry Banking **Regulated status**: Regulated banks
Participant email address: No selection **Time periods**: 2019-11-18 - 2020-04-01

Banks are reasonably engaged with high level strategy and planning

Does your part of the legal function have/maintain written versions of the following?



– But spend less time on detailed analysis of their 'as is' condition – which may hamper efforts to move towards the desired target operating model.

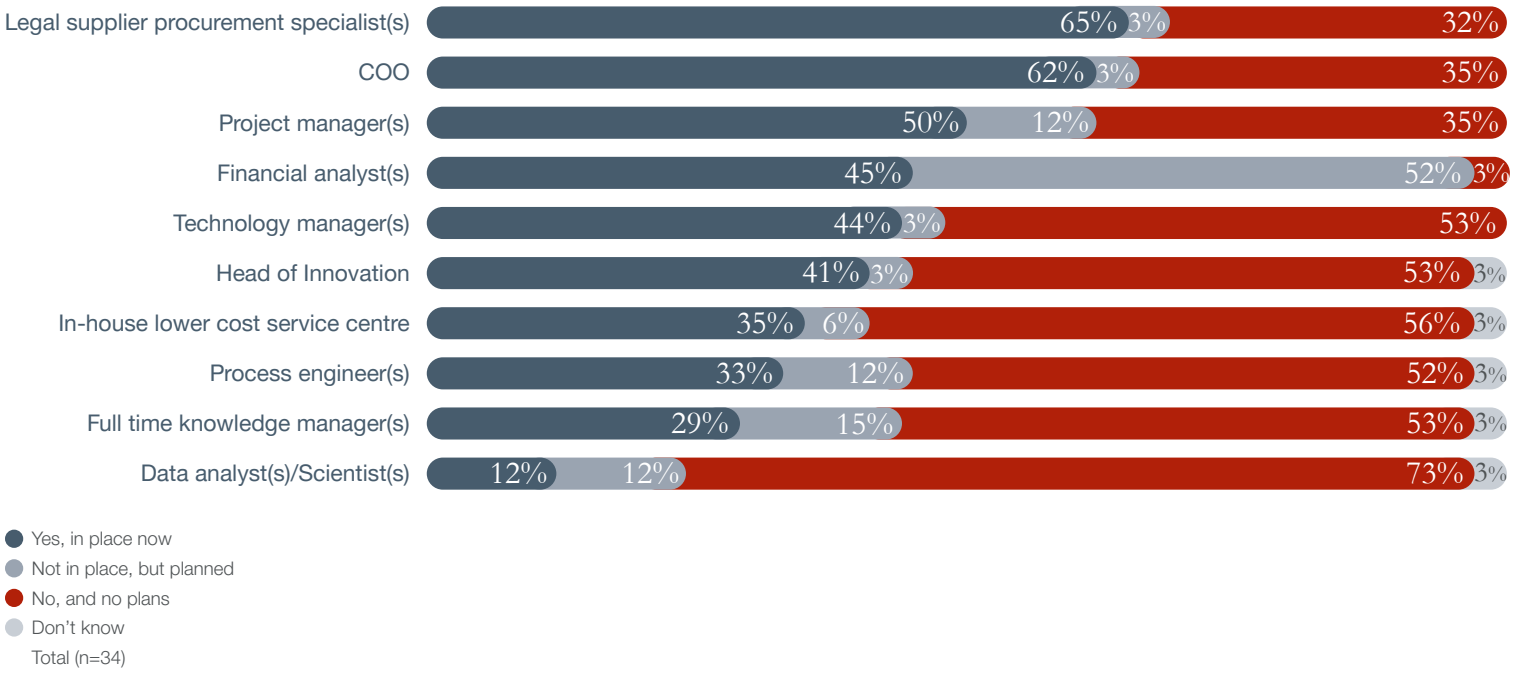
– Understanding the tech landscape and articulating the way forward in a tech roadmap remains a challenge.

CONTENTS

Filters applied: Industry Banking **Regulated status**: Regulated banks
Participant email address: No selection **Time periods**: 2019-11-18 - 2020-04-01

Banks are embracing more diverse skills within Legal

Which of the following positions or resources does your organisation currently have dedicated to your part of the legal function?



– But innovation in legal service delivery generally involves some combination of technology, process, data and alternative resourcing – and banks are not giving enough priority to those skills.

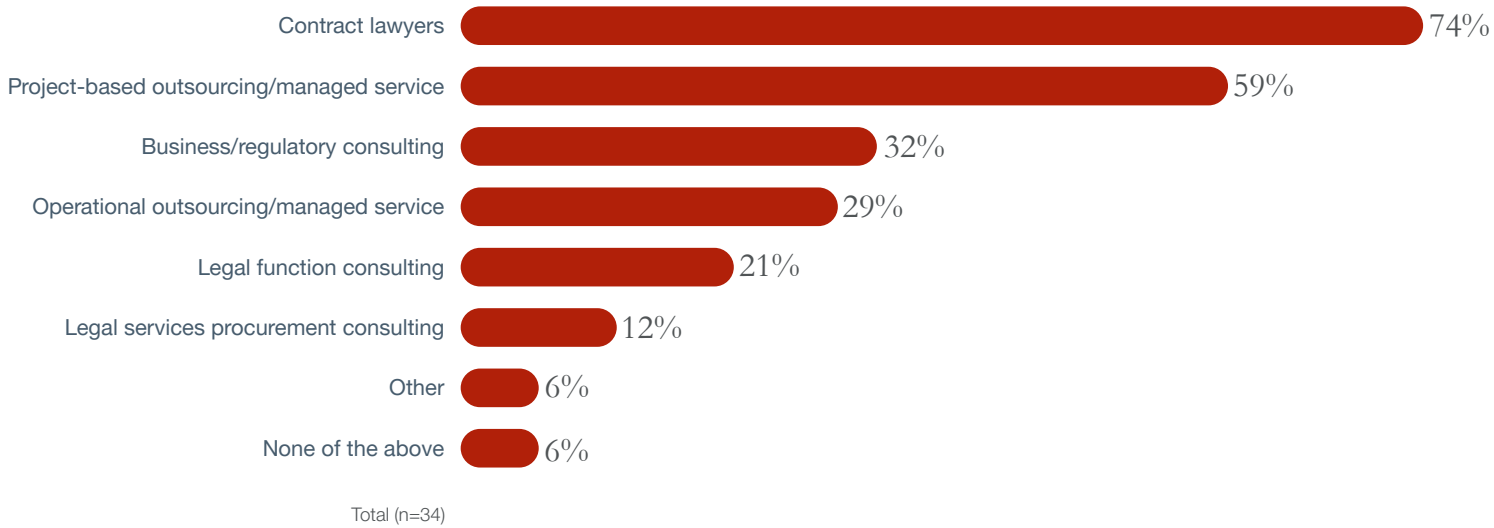
– Better data is the most commonly cited driver, yet only 12% have data specialists.

CONTENTS

Filters applied: Industry Banking **Regulated status**: Regulated banks
Participant email address: No selection **Time periods**: 2019-11-18 - 2020-04-01

Banks use contract lawyers and project-based managed services extensively

Does your legal function use any of the following external resourcing/advisory models?



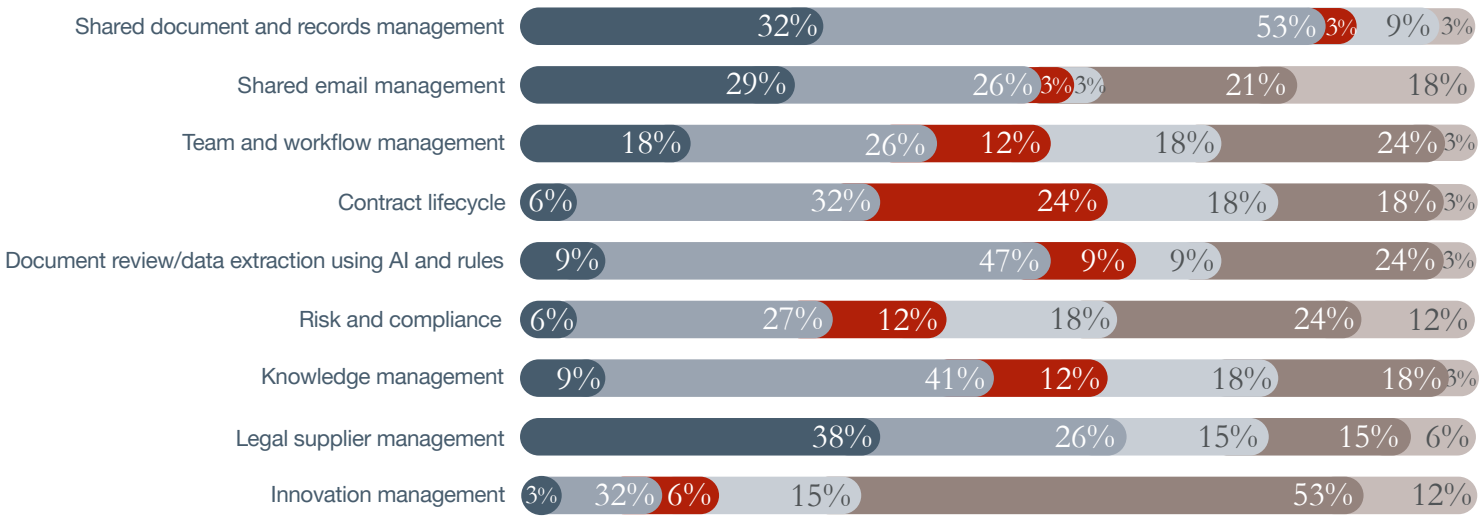
– But fewer banks use operational managed services and consulting

CONTENTS

Filters applied: Industry Banking **Regulated status**: Regulated banks
Participant email address: No selection **Time periods**: 2019-11-18 - 2020-04-01

Banks are not using technology extensively

Which of the following technologies does your legal function currently use?



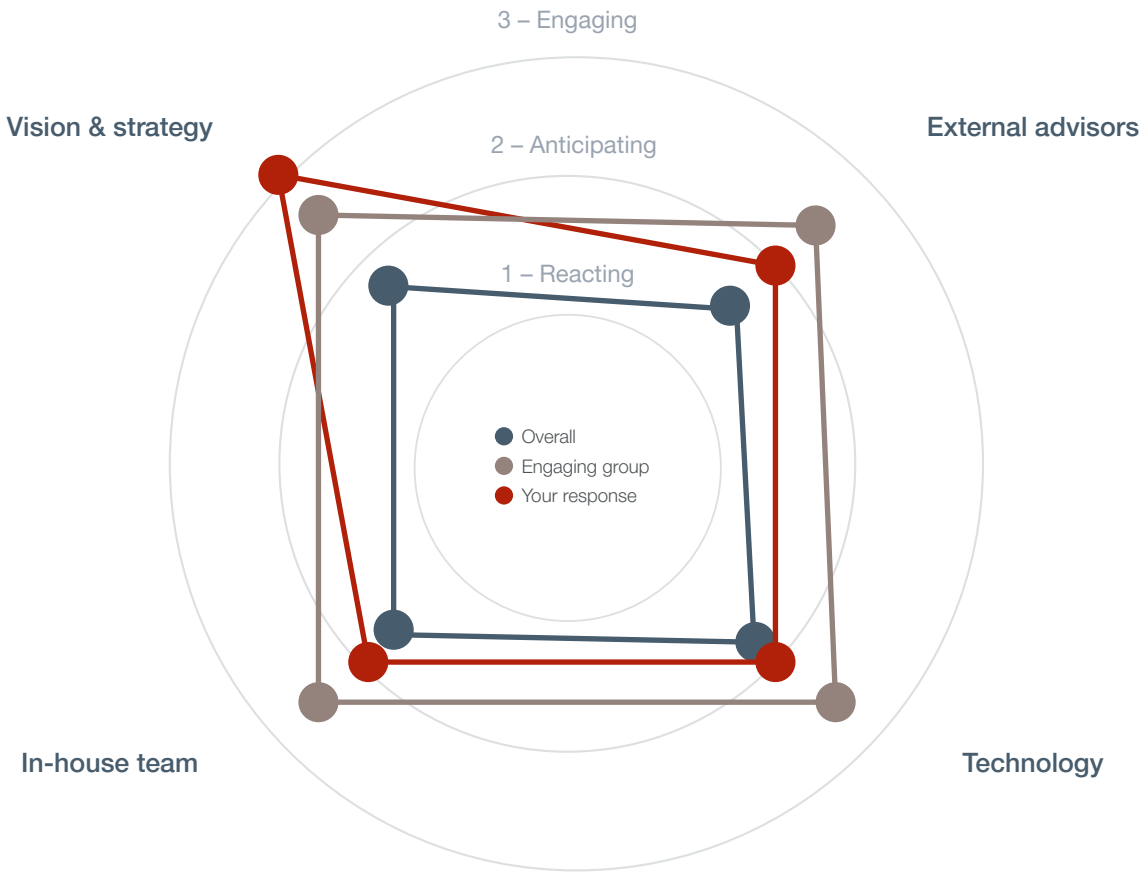
Total (n=34)

– But are engaged in extensive trialling, piloting and planning, which suggests the industry is at the start of a process of change

CONTENTS

Filters applied: Industry Banking **Regulated status**: Regulated banks
Participant email address: No selection **Time periods**: 2019-11-18 - 2020-04-01

Summary for client



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Fuse

by ALLEN & OVERY

Fuse is Allen & Overy's collaborative tech innovation hub/community of change.

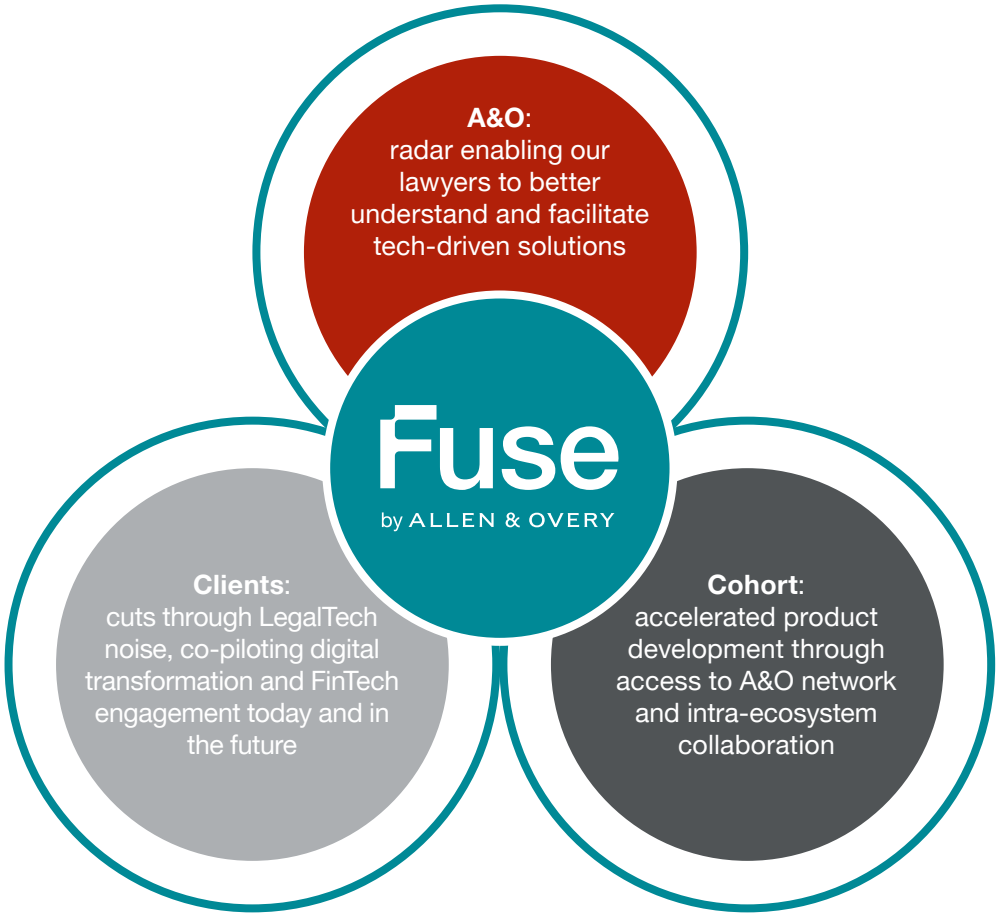
"This is a unique opportunity for technology companies to develop and pilot their products with unrivalled access to A&O lawyers, technologists and our global client base."

Shruti Ajitsaria
Partner and
Head of Fuse

CONTENTS

Why?

- To fuel a culture of digital innovation in the legal sector
- Enables A&O lawyers and our clients to co-develop ideas with some of the brightest and most promising entrepreneurs
- Collaborative learning lab where teams can experiment with, develop and test the latest legal, regulatory and deal-related solutions.
- Provides our lawyers with hands-on experience of emerging technologies and enables our clients to discuss possible applications for their business
- Benefits for (1) A&O, (2) the cohort members and (3) clients



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Who?

Cohort 4: FinTech in Focus

LegalTech – Alumni

Avvoka
Define
Nivaura
REGnosys

LegalTech – New to Fuse

BRYTER
Clara
Serein
StructureFlow
Orbital Witness

FinTech – New to Fuse

Loan Optics
Secretarium
Saphyre
Proxymity

In 2020, we accepted four FinTech nominations, being from Citi Ventures, Société Générale, ING and J.P. Morgan. The nominated FinTechs in Cohort 4 were as follows:

Secretarium helps businesses to achieve fast, confidential computing by using cryptography, consensus algorithms and specialist hardware to achieve end-to-end encryption and tamper-proofing of data at rest, in transit and in use.

Loan Optics streamlines the primary and secondary loan implementation process to make the syndicated loan market digitally native, thus driving significant operational savings.

Saphyre enables firms to assess risk faster, speed up their ready to trade process with accuracy and eliminate redundant or inefficient processes in booking, confirmation, and settlement. The platform organises data with an end-to-end workflow involving multiple stakeholders.

Proxymity provides a real-time and fully transparent electronic proxy voting solution. The platform removes the need for manual and often paper-based processing which slows down the current system and makes it opaque. It also offers a shareholder disclosure platform, which automates shareholder ID requests in industry compliant formats without the need for any manual intervention.

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Who?

Cohort 4: Success snapshot

LMA.Automate, a wholly owned subsidiary of the **Loan Market Association**, announced that it has entered into a project contract with Allen & Overy and **Avvoka**, to establish a documentation automation platform in respect of certain LMA recommended form documents, as well as other ancillary services.

A&O entered into a contract with **Orbital Witness** to provide licences to their software for use primarily by A&O London's Real Estate team.

A&O licenced the technology of **Define**, a 360 degree 'one-click' defined terms solution.

A&O also obtained licences for **StructureFlow**, a dynamic data-rich tool enabling lawyers to model complex transactions more easily and visually.

Secretarium won a UK Research & Innovation grant to enable privacy-preserving collaboration on Covid-19 data.

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GLOBAL PRESENCE

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