

# ALLEN & OVERY



## *Key Regulatory Topics: Weekly Update*

13 – 19 September 2019

### **BREXIT**

#### **Preparing for Brexit in financial services: the state of play**

On 16 September, the Chief Executive of the FCA, Andrew Bailey, delivered a speech on the state of play of preparations for Brexit in the financial services sector. Mr. Bailey expressed no doubt that financial sector preparations for no deal Brexit had advanced over the course of this year. However, the FCA is not complacent and there are a number of issues that in one form or another require further action, either in the UK or the EU. The FCA will take a pragmatic approach to the issues as they arise. It will use forbearance generously but appropriately, to maintain market integrity and protect consumers and market uses.

[Read more](#)

### **CONDUCT**

Please refer to the Other Developments section for an update regarding the FCA's Regulation round-up – September 2019.

#### **Tackling Culture in Different Sectors**

A&O Consulting has published an article entitled, "Tackling Culture: Culture Case Studies – 7 Common Themes". For more information, please click [here](#).

### **FINANCIAL CRIME**

#### **MEPs call for proper implementation of anti-money laundering rules**

On 19 September, the EP announced that in a resolution adopted on 19 September, with 530 votes to 14 and 104 abstentions, MEPs said anti-money laundering rules needed coordinated and speedy implementation. MEPs see the lack of cooperation and poor information-sharing between national authorities and Financial Intelligence Units as the main obstacles to preventing money-laundering, criminal financing and terrorist financing in all member states. The EP calls on the Commission to assess, in the context of the required impact assessment for any future revision of the AML legislation, whether a regulation would be a more appropriate legal act than a directive. MEPs also issued a reminder that the beneficial ownership registers for corporate and other legal entities should be ready by 10 January 2020 and for trusts and similar legal arrangements by 10 March 2020 and urged member states to accelerate the work. The EP instructs its President to forward this resolution to the Council, the EC and the governments and parliaments of the Member States.

[Press release](#)

[Texts adopted](#)

### **INSURANCE**

#### **Solvency II: Prudent Person Principle**

On 18 September, the PRA published a consultation paper (CP 22/19) on a draft supervisory statement (SS) relating to the prudent person principle (PPP) under Solvency II. The draft SS sets out the PRA's proposed expectations of firms relating to the PPP as set out in Chapters 2 to 5 of the Investments part of the PRA

Rulebook. The PRA's proposed expectations relate to a firm's investment strategy, investment risk management and governance system. The draft SS sets out specific areas (e.g. asset class concentration and intra-group investment) where the PRA would expect firms to pay particular attention in order to comply with the PPP. The draft SS also identifies circumstances under which firms may be subject to greater supervisory scrutiny. The deadline for responding is 18 December.

[Read more](#)

### **Cyber risk for insurers – challenges and opportunities**

On 17 September, EIOPA published a report which looked at the challenges and opportunities for insurers regarding cyber risk. The report discovered that the most common cyber risks that affect insurers are: (i) phishing mail; (ii) malware infections; (iii) data exfiltration; and (iv) denial of service attacks. The key finding was that the need for a deeper understanding of cyber risk presents the core challenge for the European cyber insurance industry. EIOPA calls for a sound cyber resilience framework for issuers and in particular, clear, comprehensive and common requirements on the governance of cybersecurity as part of operational resilience. This would include a consistent set of definitions and terminology on cyber risks to enable a more structured and focused dialogue between the industry, supervisors and policymakers, which could further enhance the cyber resilience of the insurance sector. Overall, this report provides new information about cyber risk for the European insurance sector, both from an operational risk management perspective and an underwriting perspective, based on the responses of 41 large (re)insurance groups across 12 European countries representing a market coverage of around 75% of total consolidated assets.

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### **PRA: Latest Solvency II updates**

On 16 September, the PRA's webpage on Solvency II was updated in order to provide information relating to the recalculation of the transitional measure on technical provisions (TMTP) under the Solvency II Directive. The PRA has been monitoring market conditions since the previous biennial TMTP recalculation (as at 31 December 2017), and has also been considering whether changes in market conditions since the end of June can reasonably be considered to have been sustained. In its view, if the current market conditions persist, the PRA would be willing to accept applications from firms to recalculate TMTP as at Monday 30 September. In any application, the PRA expects firms to be able to demonstrate that a material change in risk profile has occurred. Applications would be in addition to the expected biennial TMTP recalculation as at 31 December. This is relevant to all firms with current TMTP approval.

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## **MARKETS AND MARKETS INFRASTRUCTURE**

Please refer to the Recovery and Resolution section for an update regarding the recovery and resolution of CCPs.

### **Financial industry joins to warn EC about inappropriate timeframe to apply new EU sustainability disclosure rules**

On 19 September, a large group of financial industry associations raised serious concerns in a joint letter to the EC regarding the current application timeline for new EU disclosure rules for sustainable investments and sustainability risks. While supporting the EC's objectives of financing a more sustainable economy, the signatories warned that the Regulation is very likely to become applicable before the related Level 2 measures are even adopted. This will create significant compliance challenges and liability risks for the financial companies which need to apply the Regulation, as well as confusion for investors. The signatories therefore urged the EC to take immediate action to ensure that the financial industry is provided with a realistic timeframe for implementation. To this end, the signatories suggested that the application of the new requirements in the Regulation takes place at least one year after all the Level 2 texts are published in the OJ.

[Read more](#)

### **Improving the suitability of financial advice**

On 19 September, the FCA published a speech given by the Director of Life Insurance and Financial Advice Supervision at the FCA, Debbie Gupta. Ms. Gupta highlights 4 broad areas of focus for the Life Insurance and Financial Advice Supervision at the FCA: (i) improving standards; (ii) targeting firms that cause the most harm; (iii) supporting consumers; and (iv) helping advisers. The area of greatest concern to the FCA is unsuitable advice on defined benefit (DB) pension transfers. The findings from the FCA's DB work show that only around 50% of the advice given on DB transfers was suitable. Furthermore, a recent consultation paper

covers the areas the FCA feels need further specific action, which include: (a) conflicts of interest, including a ban on contingent charging for the majority of consumers; and (b) encouraging greater engagement from consumers with the advice process. Ms. Gupta goes on to highlight examples of good and bad practice in relation to each of these areas.

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#### **Update to June 2019 joint statement on opportunistic strategies in the credit derivatives market**

On 19 September, the FCA published an update to the June joint statement of the SEC, CFTC and the FCA on opportunistic strategies in the credit derivatives market. Opportunistic strategies include, but are not limited to, what have been referred to as 'manufactured credit events' or 'narrowly tailored credit events'. The June statement outlined concerns about the pursuit of these strategies and the adverse impact they may have on the integrity, confidence and reputation of the credit derivatives markets, as well as markets more generally. The FCA expects firms to consider how opportunistic strategies may impact their businesses and to take appropriate action to mitigate market, reputation and other risks. ISDA recently released a proposed protocol designed to address certain issues related to narrowly tailored credit events. The FCA directs firms to consider how adherence to the proposed protocol may help them mitigate the risks. Firms should also consider the risks to which they may be exposing themselves by trading with counterparties who do not adhere to the proposed protocol (and where such trades do not then include the amendments to mitigate the risks associated with narrowly tailored credit events). The FCA stress, however, that the proposed ISDA protocol will not by itself address many of the concerns identified in the joint statement, such as opportunistic strategies that do not involve narrowly tailored credit events. The FCA encourages further industry efforts to improve the functioning of the credit derivative markets.

[Read more](#)

#### **FCA finds MiFID II research unbundling rules working well for investors**

On 19 September, the FCA published multi-firm review findings indicating that the MiFID II research unbundling rules have improved asset managers' accountability over costs, saving millions for investors. The review and analysis also found that: (i) the way most buy-side firms have implemented the new rules has improved accountability and scrutiny over both research and execution costs. Most firms have chosen to absorb research costs themselves. This resulted in around £70 million of savings for investors in UK-managed equity portfolios across our sample in the first half of 2018 compared with 2017; (ii) most buy-side firms can still access the research they need. The FCA found no evidence of a material reduction in research coverage, including for listed SMEs; (iii) asset managers' research valuation models have different levels of sophistication, particularly in evaluating the quality of research. The FCA expects firms to refine models to ensure they are acting in the best interests of their clients; (iv) there are a wide range of sell-side research pricing levels, which the FCA attributes to an ongoing process of price discovery. The FCA will monitor for potential competition concerns in this market and will act if necessary; and (v) in some cases, firms have been uncertain in how the new rules apply, such as when attending trade association events, marketing research services or making contributions to consensus forecasts. Firms are continuing to develop their arrangements and a market for separately priced research is still emerging. Therefore, the FCA intends to undertake further work in 12 to 24 months' time

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#### **Financial Services and Markets Act 2000 (Benchmarks) (Amendment) Regulations 2019**

On 13 September, the Financial Services and Markets Act 2000 (Benchmarks) (Amendment) Regulations 2019 and an explanatory memorandum were published. The 2019 Regulations amend the Financial Services and Markets Act 2000 (Benchmarks) Regulations 2018, which in turn implement the BMR into UK law. The 2019 Regulations amend the definition of a "miscellaneous benchmarks person" to include a person who administers a benchmark in accordance with Article 46(8) of the BMR and clarify the scope of the FCA's powers in respect of miscellaneous benchmarks persons. The Regulations were laid before Parliament on 13 September and will come into force on 14 October.

[Statutory instrument](#)

[Explanatory memorandum](#)

### **PAYMENT SERVICES AND PAYMENT SYSTEMS**

#### **PSR update on its approach to the profitability analysis for its market review into card-acquiring services**

On 18 September, the PSR updated its approach to the market review into the supply of card-acquiring services. In light of the responses received to its July consultation, which set out two proposed pieces of analysis, gross profit margin (GPM) and return on capital employed (ROCE), the PSR has concluded that

GPM is more likely to provide useful analysis for its review and it therefore won't be assessing ROCE. Overall, the PSR believes that ROCE will be more complex and require significantly more resources for little incremental benefit to its review. The PSR is confident that GPM, when taken with the other evidence it is gathering in the review, will enable it to understand whether the supply of card-acquiring services is working well for merchants, and ultimately consumers.

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## **EC FAQs on PSD2**

On 13 September, the EC published FAQs on PSD2. The questions include: (i) what PSD2 is; (ii) what SCA is and how it will apply; and (iii) how PSD2 will change the payments markets.

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## **PRUDENTIAL REGULATION**

### **Credit risk: Probability of Default and Loss Given Default estimation**

On 18 September, the PRA published a consultation paper (CP 21/19) which sets out its proposed approach to implementing the EBA's guidelines and RTS relating to Probability of Default (PD) estimation, Loss Given Default (LGD) estimation and the treatment of defaulted exposures in the Internal Ratings Based (IRB) approach to credit risk. The PRA proposes to update its expectations in Supervisory Statement 11/13 'Internal Ratings Based (IRB) approaches'. This CP (including the proposed changes to SS11/13) assume that the RTS will be made in the same form as the draft. The PRA will consider further changes that may be required to SS11/13 if the final RTS differ from the current draft. The deadline for responses is 18 December.

[Read more](#)

### **PRA: Supervision – Credit unions**

On 17 September, the PRA published letters sent to directors of category 5 credit unions which set out the findings of its 2019 assessment of these firms. Category 5 credit unions are divided into: (i) those with total assets above £15 million or with more than 10,000 members (large credit unions); and (ii) those with total assets of less than £15 million and fewer than 10,000 members (small credit unions) and the letters differed slightly according to which category a firm fell into. For both groups, the PRA sets out its supervisory expectations relating to governance and operational risk and resilience and cybersecurity. The letter to large credit unions also discussed the PRA's expectations for management and monitoring of liquidity and, the letter to small credit unions, its expectations concerning the single customer view (SCV) and orderly resolution, internal fraud and provisioning.

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### **PRA: Waiver by consent of the Continuity of Access rules**

On 13 September, the PRA issued a waiver by consent regarding the continuity of access (CoA) rules in the Depositor Protection Part of the PRA Rulebook (DPP). As part of the suite of reforms introduced during the transposition of the Deposit Guarantee Schemes Directive (DGSD) in 2015, the PRA introduced rules in the DPP requiring firms to put in place systems to ensure eligible depositors have continued access to FSCS-covered deposits in resolution or insolvency by facilitating a transfer of such deposits (CoA). The unmodified rules required all firms subject to the CoA rules in the DPP to meet these requirements by 1 December 2016. Since 2016, the BoE has publicly committed to reviewing the calibration of MREL before the end of 2020. This review may lead the PRA to consider adjustments to the scope, functionality and necessity of the rules on CoA. Pending the outcome of the review, the PRA is providing a new waiver by consent for the CoA rules with an expiry of 1 December 2022. This waiver by consent is available in relation to a firm if it meets specific criteria. The waiver exempts a firm from the CoA rules and from the related CoA reporting requirements.

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## **RECOVERY AND RESOLUTION**

### **Recovery and resolution of CCPs**

On 16 September, the Department for Exiting the EU published letters sent by John Glen to the Chair of the EU Committee, Lord Kinnoull and the Chair of the European Scrutiny Committee, Sir William Cash, and which provide a current state of play as regards the proposed regulation on CCP recovery and resolution. The key points include: (i) following the finalisation of the EMIR REFIT and EMIR 2.2 files, the Council of the EU working group resumed work on this proposed file in May; (ii) the Finnish Presidency have indicated that they intend to reach a general approach in December with trilogues expected to commence in January; (iii) the form of the proposed regulation remains "broadly consistent" with CPMI, IOSCO and FSB standards; (iv) the position regarding the NCWO counterfactual has progressed since original discussions back in 2017 and

recent discussions have focused on including replacement costs in the NCWO counterfactual – the UK position on this is that it should only cover ‘direct’ replacement costs; (v) there has also been progress on the requirements for recovery plans – the UK has argued that CCPs have always been intended to be self-standing entities and should not rely on group structures in a resolution scenario; and (vi) there are a number of areas where agreement in the working groups is yet to be reached, for example, in relation to the treatment of CCP equity in resolution. The letter references the FSB work in this area and the guidance is expected next year.

[Letter to the Chair of the EU Committee](#)

[Letter to the Chair of the European Scrutiny Committee](#)

## **OTHER DEVELOPMENTS**

### **MoU between the BoE and the Financial Services Compensation Scheme Ltd**

On 19 September, the BoE and the FSCS published an updated MoU between the FSCS and BoE. The MoU sets out the high-level framework the PRA and the FSCS use to co-ordinate and co-operate in carrying out their respective responsibilities. The MoU has been updated to reflect some minor changes to certain legislative functions and other organisational changes. As part of this recent update, the title of the MoU was also changed to reflect the PRA becoming fully integrated into the BoE, following its de-subsidisation in March 2017.

[Read more](#)

### **FCA: Regulation round-up – September 2019**

On 19 September, the FCA published a Regulation round-up, which addressed various issues, such as: (i) an encouragement to register on Connect ahead of January 2020 and the ability for banks, building societies, credit unions and insurance companies to submit data for the new Directory now; and (ii) a warning about informing the FCA about competition investigations. The FCA stated that some firms are not notifying it immediately when a competition authority has started an investigation or imposed disciplinary measures or sanctions against them. Under FCA rule SUP 15.3.15(3), firms are required to notify the FCA in these circumstances. The FCA will continue to monitor this and will consider using regulatory powers if non-compliance continues.

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