FINANCIAL SERVICES REGULATION

Exchange – International

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Introduction

Welcome

DLA Piper's Financial Services International Regulatory team welcomes you to the 45th edition of Exchange – International, our international newsletter designed to keep you informed of regulatory developments in the financial services sector.

This issue includes updates from the UK, the EU, contributions from Ireland, Spain, France, Germany, China and the US, plus international developments.

In this edition, In Focus looks at Diversity and Inclusion in the financial services sector, which has become an increasingly topical regulatory issue.

In the UK, the Financial Conduct Authority (FCA) has published its first post-Brexit consultation and we analyse the proposed reforms affecting capital markets, particularly with regards to the MiFID framework. We also comment on the new Taskforce between the Bank of England and HM Treasury, which aims to explore the creation of UK Central Bank Digital Currency (CBDC), and discuss how this may revolutionise the UK payments system. In addition, we provide insights on the implementation of Basel III standards in the UK and how these may differ from the corresponding EU standards post-Brexit.

In the EU, we provide an overview of the proposed EU-Wide Instant Payments Scheme and how this may transform the EU payments landscape. We also analyse the key takeaways from the French financial markets authority 2020 annual report and provide insights on Spain's new regime regarding cryptoassets and their marketing.

We also comment on the US Federal Reserve Board's proposed new guidelines that could allow fintechs to qualify for accounts and payments services and also examine the Financial Stability Board's letter to G20 Finance Ministers And Central Bank Governors, which sets out the FSB's key priorities for 2021.

If you have any comments or suggestions for future issues, we welcome your feedback.

The DLA Piper Financial Services Regulatory Team

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UK

First FCA consultation on reforming capital markets post-Brexit

On 28 April 2021, the FCA published Consultation Paper 21/9 (CP 21/9), which sets out proposals to amend conduct and organisational requirements under MiFID II (as implemented in the UK) in relation to SME and fixed income currencies and commodities (FICC) research inducement rules and best execution reports.

This is the first in a series of consultations arising out of the capital markets reform work that the FCA is conducting with HM Treasury to ensure that capital markets regulation better meets the FCA's regulatory objectives and the specificities of the UK financial services environment post-Brexit.

The FCA is proposing to:

- introduce exemptions from the inducement rules for:
  - research on listed or unlisted SME companies that have a market capitalisation below GBP200 million provided it is offered on a rebundled basis or for free;
  - third-party research received in connection with investment strategies that relate primarily to fixed income currencies and commodities (FICC) instruments;
  - research received by independent research providers where this does not involve execution; and
  - openly available written material.
- remove the obligation on execution venues to prepare RTS 27 reports, and for investment firms to prepare RTS 28 reports.

Investment Research Rules

Before the entry into force of MiFID II in January 2018, the costs for the provision of investment research by investment banks and broking houses were often bundled into trading commissions payable by buy-side institutions, which were passed on to the clients of those institutions. For example, there might have been one level of trading commission payable for firms that did not receive investment research, and a higher level of commission payable for firms that did.

A number of issues were identified with this approach, including lack of price transparency for end clients in relation to both research and execution costs. Indeed, the amount a firm paid for research would not necessarily correlate to the amount of research they received, nor how valuable they found it, but instead to the volume of trades placed with a particular investment bank or brokerage. These issues were addressed by certain measures under MiFID II which required the payment for research to be "unbundled" from trading commissions. Firms receiving research were required to either pay for research themselves from their own resources, or agree a separate research charge with their clients.

This change required investment banks and broking houses providing investment research to completely restructure the means through which they were paid for research. In particular, they were required to put a price on their research and amend the arrangements they had with buy-side firms. Since buy-side firms had to pay for research themselves or have clients contribute to a research pot, this may have focused their minds on the quantity and quality of research being received, and the price being paid.

In its Consultation Paper, the FCA noted that MiFID II requirements apply to research regardless of the market capitalisation and size of the company being covered, or a consideration of the risk of harm caused by bundling in different parts of the equity market, eg research on SME companies.

As part of its supervisory work in this area, the FCA found, among other things, that:

- buy-side budgets for equity research have declined around 20-30% following the introduction of MiFID II;
- the number of analysts per public company with a market cap below GBP1 billion remained constant following the introduction of MiFID II (c.1.6 analysts per company);
- 79% of public companies with a sub-GBP250 million market cap have either no coverage, or are covered by a single analyst (the FCA did not state what the position was pre-MIFID II); and

- over a five-year period, there has been a slight increase in AIM-quoted companies with multiple coverage, although there has also been a slight increase in AIM-quoted companies with no research coverage post-MiFID II (from c. 40% to 44%).

The FCA also noted that most corporate issuers they spoke to had not seen negative impacts from MiFID II on their ability to raise capital, but that some had concerns about future coverage and quality. In particular, due to lower sums being paid for research, they were concerned about a decline in number of sell – side analysts, each analyst covering more companies (resulting in less time spent in respect of each company), and the decreasing seniority of analysts due to increasing use of junior analysts.

Equity research is a vital tool in the price formation process for publicly traded companies, ensuring that information about a company is disseminated and analysed and feeds into market price. Accordingly, in light of their findings in relation to research on SME companies, the FCA decided to focus its regulatory amendments to this area.

In addition to the rules in relation to SME research, the FCA decided to change the research rules in relation to FICC instruments, independent research providers where the providers do not provide execution services, and openly available written material. In these areas, the FCA considers that the scope for potential conflicts is lower.

Best Execution Reports

MiFID II introduced requirements for execution venues and firms executing and transmitting client orders to publish certain information regarding execution quality and order routing.

In particular:

- RTS 27 requires trading venues to publish reports on execution quality on a quarterly basis and include data for each trading day. A variety of fields are required to be included in these reports, including identification information of the execution venue and financial instrument, price information, costs information, and information regarding the likelihood of execution.
- RTS 28 requires firms executing and transmitting client orders to publish an annual report listing the top five execution venues for client orders in the past year, along with a summary of execution outcomes achieved.

The purpose of these reports was to provide market participants and clients with information to compare execution venues and assist them in choosing firms or venues.

From its policy work and discussions with market participants, the FCA found that the respective reports had not achieved their policy goals, and that intended audiences for the reports did not read them. Further, the FCA noted that the data in those reports could be difficult to extract, is overly complex, and market participants did not find the data usable.

Accordingly, the FCA proposes to remove the requirements to publish RTS 27 and 28 reports for trading venues and firms executing and transmitting client orders respectively. This is likely to result in cost savings for venues and firms and increased efficiency.

DLA Piper Comment

It will be interesting to see whether the FCA's amendments to the rules regarding research increase the amount of research being produced on SMEs and how much additional revenue will be generated for the production of research on SMEs. Indeed, the FCA recognised that the volume of transactions in the shares of SMEs was low and therefore allowing the rebundling of research and trading commissions for SMEs presented a low risk of harm. The rebundling may therefore not generate much additional revenue to be spent on producing this research.

Further, both buy – and sell-side investment firms have now established processes and contractual structures for the splitting of research costs and trading commissions. It will therefore be interesting to see whether investment banks and broking houses will incur the additional costs of restructuring their relationships to rebundle SME research, particularly where the revenue from doing so may be limited, and whether buy-side firms will be willing to accept this in any event.

It is promising that the FCA, in conjunction with HM Treasury, is conducting a review of capital markets regulation in order to determine areas for reform post – Brexit.

Certain areas of EU regulation have attracted critics from market participants in the UK as being overly burdensome, trying to encapsulate too wide a range of market structures at varying degrees of sophistication across the EU. Further, some of the EU capital markets regulation appears to be a "tick-box" exercise without a proper assessment of whether regulation is meeting its

stated aims. The RTS 27 and 28 best execution reports are good examples of this.

The FCA's and HM Treasury's work may identify areas of regulation that are not working or that are overly burdensome, and will allow capital markets regulation to be tailored to the UK's market structures. It is hoped that this will allow the UK's capital markets to remain competitive in a post-Brexit world (particularly in absence of an equivalence decision) while maintaining the highest standards.

The changes proposed in CP 21/9 do not push the boat out in terms of change, with similar amendments being implemented as part of the European Commission's MiFID "quick-fix" package on 26 February 2021. However, it is a step in the right direction.

Next steps

The FCA's and HM Treasury's capital markets reform work will be looking at the following priority areas:

- market structure
- pre – and post-trade transparency for shares, bonds and derivatives
- the cost and distribution of market data
- commodity derivatives markets

HM Treasury is due to publish a consultation paper in the summer, looking at the broad themes of capital markets reform, which will help prepare the ground for further regulatory change proposals. The FCA intend to publish at least a further two consultation papers in 2021, covering:

- consequences of LIBOR transition for the Derivatives Trading Obligation; and
- changes to market requirements in the FCA Handbook and technical standards that can be effective without significant supportive legislative change.

Sterling work: Bank of England and HM Treasury announce CBDC Taskforce

UK Central Bank Digital Currency (CBDC) moves one step closer: The Bank of England is clearly interested in the economic and social opportunities associated with use cases for digital currency and on 19 April 2021, alongside HM Treasury, it announced the creation of a UK Taskforce to explore creation of UK CBDC. With this announcement we are one step closer to digital GBP (dGBP), which would revolutionise the payments system and create additional, stronger bridges into other digital assets for use by all.

This latest step follows the CBDC discussion paper released by the Bank of England in March last year. Core to these initiatives is the recognition that, as society transitions towards digital and e-money, the role of central banks as currently presented – in respect of cash and money supply – would be reduced unless CBDC is embraced.

The Bank of England has already demonstrated its forward-thinking stance on these matters, taking a leading role last year – alongside six other central banks – in producing the Bank for International Settlements' Central Bank Digital Currencies foundational principles report. However, it is not as far ahead as some. Other countries, including China and the Bahamas, have already released their own CBDCs and there will no doubt be lessons that have to be learned before the right solution is found here in the UK. In the US, Jerome Powell of the US Federal Reserve commented recently that the digital dollar is a "high priority project" for them; however, commentators have noted that any issuance is likely to be at least a couple of years away.

There are many potential benefits and challenges to such a venture. Privacy and data concerns are often high on the agenda for those opposed to CBDC, as well as accessibility, security and many other technical concerns.

The recent announcement was cautiously drafted, noting that the government and the Bank of England have not yet made a decision on whether to introduce a CBDC in the UK, but will take a strategic approach in coordinating between authorities and stakeholders in deciding how to move forward. However, we understand this to be a significant positive step towards planning for these eventualities. The Taskforce will be supported by technology and engagement forums which will play a vital role in mapping out the relevant stakeholders' interests and considering how technology can be used to maximise the benefits and minimise the risks within a widely available CBDC currency. Alongside the broader digital assets activities being undertaken across government, we expect that the taskforce will make significant steps in planning how digital money will be shaped as an integral part of the UK's future economy.

Consumer credit: A review of change and innovation in the unsecured credit market. Who does this affect and what does it mean?

On 2 February 2021, the FCA published a report (the report) on the findings of its review on change and innovation in the unsecured credit market led by the FCA's former interim CEO Christopher Woolard. The review sought the views of a wide range of participants, both in the UK and internationally and three roundtables were held to discuss topics under review, information on the discussions at these roundtables can be found here.

Implications

The findings of the report will lead to further changes in the regulation of the consumer credit sector:

- It proposes that Buy Now Pay Later (BNPL) firms currently exempt from regulation become regulated.
- This is also relevant to retailers who offer customers these currently unregulated deferred payment options. Those who introduce third-party credit usually have to be authorised themselves.
- Regulated lenders providing unsecured credit should have regard to the proposals relating to forbearance, the role of, and evolution of, regulation for digital customer journeys, and an emphasis on whole product lifecycle outcomes-based regulation.
- The importance of credit information and role of credit reference agencies is highlighted, with attention on what information is gathered, how it is analysed and how it is used to inform lending decisions.
- Attention is given to the role of firms providing debt management advice and solutions and alternative sources of credit.

Next steps

The FCA and HMT will work together to draft suitable proposals for changes to legislation and regulation. Proposals for change will be subject to a formal public consultation, to take into account the views of consumers, providers and retailers in order to understand the impact regulation could have.

Context

The report talks about regulation as a catalyst for reshaping the credit market since 2014, and acknowledges that the market has also seen significant product innovation and exponential growth in the provision of unregulated credit facilitated through payments services technologies and open banking. It considers that this has not only brought benefits to consumers but also caused potential consumer harm. Consumer protection is the focus of, and at the core of, the recommendations made. The report also concentrates on challenges that COVID-19 has presented for businesses and consumers and questions it has brought to the fore over affordability of credit, vulnerability of certain types of customers and the need for lenders to have access to timely, comprehensive and holistic information to help better inform lending decisions.

Recommendations

The report makes 26 recommendations for the FCA to take forward, in conjunction with support from the government and other bodies and are made with the aim of creating a healthy, sustainable and futureproof unsecured credit market.

These include:

- **Regulation of unregulated Buy-Now Pay-Later (BNPL):** BNPL products are referred to in the report as those falling under the exemption at article 60F(2) of the Financial Services and Markets Act 2000 (regulated activities) Order 2001 (as amended) which requires credit to be repaid within 12 months of the agreement by no more than 12 repayments with no interest or other charges. According to the report, this exemption was never intended for widespread use in the retail sector, having originally been created for invoice finance arrangements. The report also states that while BNPL credit has provided a useful alternative to payday loans and other forms of credit, it can also present significant potential for consumer

harm, taking into account how consumers use and understand it, and should now be regulated in a proportionate way.

It acknowledges that non-financial organisations which use the same exemption for services such as healthcare or sports club memberships should not be brought into regulatory scope. It is recommended that the proposed framework should also address how credit information should be collected and used in the market, seek to ensure affordability is appropriately assessed, information about customers with multiple BNPL products appropriately reported and taken into account and address the treatment of consumers in financial difficulty.

- **Employer Salary Advance Schemes (ESAS):** The report recognises that these offer a low cost alternative to high-cost credit and can help employees. The report does not propose that these types of schemes should be regulated, but recognises that this is an area for ongoing monitoring to assess matters such as inappropriate relationships between employers and lenders, cross-selling of inappropriate financial services products and lack of visibility with credit reference agencies. It does recommend that this market should be monitored and that a code of best practice be drawn up for adoption by scheme providers and employers.
- **Digitalisation of customer journeys for credit:** The report recognises that while smooth frictionless online journeys can benefit some customers, they may inadvertently exclude or create problems for certain types of consumer, including the vulnerable. The report emphasises the importance of informed decision-making by consumers and recommends that the FCA puts in place guidance on digital design for consumer credit that focuses on good consumer outcomes and revises disclosure requirements to become more appropriate for the digital age. This responds to concerns raised by lenders and consumer representatives. In line with wider concerns about digital exclusion, the report also says that the FCA should ensure that the growth of digital does not unduly exclude consumers.
- **Forbearance:** The report acknowledges that affordability assessments and effective forbearance can help to reduce harm where consumers have difficulties in meeting repayments. It is recommended that the FCA, working with lenders and the credit reference agencies, should review and identify areas for improvement relating to how forbearance can be consistently applied and how this can be accurately reflected in credit information used for making lending decisions.
- **Credit Information:** The report stresses the critical role of credit information in supporting the healthy operation of the credit market and suggests that the FCA should resume its market study to look at improvements to information quality, use of open banking data, mandatory reporting requirements, and the speed and sharing of information across the credit sector. It also states that the FCA should make clear the outcomes which the market needs to achieve for a healthy market for both consumers and lenders, including where consumers have contact with credit reference agencies and credit information services. A further matter raised is that the infrastructure for how credit information is submitted and shared should be reviewed and a plan put in place to update systems.

- **Consumer Credit regulation and outcomes-focussed reform:** The report recommends that the FCA should set out clear outcomes that a healthy credit market should be achieving across all products and sectors, the priority being to consider the stages of the customer journey and lifecycle of a product. It is suggested that to help with achieving this, the FCA and HMT should engage as a priority to commence work on reforming the Consumer Credit Act (CCA).
- **Alternatives to high-cost credit:** The report recommends that the FCA should work with the government and Bank of England to help reform the regulation of and lending capacity of credit unions and community development finance institutions and for more to be done to encourage mainstream lenders to provide alternatives to high-cost credit. This includes work to look at increasing consumer awareness of alternatives to high-cost credit and risks associated with illegal money lenders.
- **Debt advice and solutions:** The economic effect of COVID-19 will continue to drive the demand for debt advice. The report suggests that the FCA should work with the Money and Pension Service, government and other agencies to ensure there is access to free debt advice for consumers and secure long-term and fair funding for the providers.
- **Relending:** The FCA should conduct a review of relending setting out clear outcomes covering repeat lending and persistent debt across all products. It should explore if additional protections are needed on relending on fixed-term loans in view of findings in its high-cost credit work.
- **Brexit:** The FCA should conduct a review to identify what additional flexibility and simplification might be achieved following exit from the EU; for example, in relation to cr disclosures such as the Annual Percentage Rate (APR) and the potential value in pound and pence credit cost disclosures.

Actions for those potentially affected

While it may well take some time to effect the necessary legislative and regulatory changes required to bring the provision of unregulated BNPL credit within scope of regulation, it will be important for lenders and intermediaries to start engaging with how proposals will affect them and planning early for the transition into regulation. This could include understanding which business activities could fall within scope of regulation, and benchmarking/gap analysis of current processes and procedures with those required across the product lifecycle for providing regulated credit; from advertising, to lending and contract formation, and post-contract conduct. Retailers who are currently offering consumers unregulated BNPL credit do so without needing to be FCA authorised. Offering customers unregulated BNPL credit at checkout is currently relatively straightforward.

Once BNPL becomes regulated credit, retailers will need to consider if they want to continue offering consumers this type of regulated payment method and work with the credit providers to determine how they can continue to do so. Introducing consumers to regulated credit may require the retailer itself to become authorised, or act as an appointed representative of a regulated firm.

Regulated lenders who offer unregulated retail point of sale BNPL credit will want to consider how they can best mitigate the impact of BNPL regulation on their retail introducers operating on an unregulated basis. Until the changes to legislation and regulation are finalised, lenders might also want to be cognisant of the messages and recommendations contained in the report relating to forbearance, credit information and in relation to the digitalisation of their customer journeys in making business decisions.

Regulated lenders should monitor and engage with proposals to revise the regulatory and conduct framework that informs their activities, from credit decisions, to lifecycle processes and governance, and forbearance. Credit reference agencies should also pay attention to the scrutiny of their market and focus on the role, nature and quality of the information they consume and supply.

UK regulatory perimeter: When does a statement become advice?

On 25 March 2021, in 24HR Trading Limited and anr v FCA , the High Court held that an unauthorised company, which had been providing trading signals via WhatsApp, had breached the general prohibition in s.19 of the Financial Services and Markets Act 2000 (FSMA 2000) by advising on investments within article 53 of Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO), without authorisation to do so.

The general prohibition in s.19 FSMA 2000 prohibits persons from carrying out specified regulated activities in the UK without being an authorised or exempt person. Art 53 of the RAO describes the specified activity of "advising" as advice:

- "given to the person in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and
- advice on the merits of his doing any of the following (whether as principal or agent): [...] (a) buying, selling, subscribing for, exchanging, redeeming, holding or underwriting a particular investment which is a security, structured deposit or a relevant investment [...]."

The company entered into contracts with its customers for the provision of trading signals, together with other services. The other services consisted of a variety of educational materials and courses providing instruction on FX trading.

It was accepted that the company in this case was not authorised or exempt. Consequently, one of the key issues was whether the trading signals constituted "advice" for the purposes of Art 53 of the RAO.

When does a tip or a statement become advice?

Drawing on a range of authorities, Justice Richards (sitting as Deputy Judge of the High Court) relied on the following propositions.

- **Mere information is not advice.** It must either be accompanied by a comment or value judgment on the relevance of the information to a client's investment decision; or must itself be a product of the process of selection that will tend to influence the investment decision of the recipient.
- **Objective test.** Whether advice is given, is to be determined objectively.
- **A recommendation as to a course of action is capable of being advice.**

The court also considered the weight that should be given to the context of the communication and a variety of disclaimers/warnings.

Context is relevant

The court accepted that the signals should be understood in context. Context considered relevant in this case included:

- what the firm had said about the signals on its own website;
- ancillary documents/materials. Customers were sent educational material or required to enrol on an FX Trading course. This included the provision of a manual on how to interpret the signals and turn them into CFDs; and
- communications sent to customers receiving the signals: boasted of success ratios; providing updates on the performance of the signals; and emphasising the lack of "hard work" required to use the signals to generate a profit.

Taking this context into consideration, the court held that the signals were advice. A reasonable recipient of the signals would conclude they constituted a recommendation to effect the specific transactions referred to and the educational context did not displace this "clear meaning" of the signals.

Disclaimers

Useful guidance on the effect of disclaimers relating to financial services advice in general is provided at paragraph 35 of the judgement: "...if a person making a statement says that it is not to be taken as 'advice,' that is at least relevant to the question of whether, viewed objectively, it is advice. However, because the matter is objective, the subjective intention of the person making the statement is not determinative. A person can give something that, viewed objectively, is 'advice' without intending to do so."

The company and its owner had issued various disclaimers and warnings. For example:

- customers were warned not to rely on the signals alone, but to deploy their own skill and judgment;
- during a particularly bad week for signal performance, a message was sent to customers warning that the signals were an 'assistance' and that customers should make efforts to learn every day via the other educational materials that were on offer;
- messages were sent claiming that information sent to customers was "general market information for education and entertainment purposes and did not constitute investment advice"; and
- customers were told to engage in "extensive independent research" before making decisions.

None of these warnings were considered to have a realistic prospect of displacing the court's conclusion that the company was providing advice of the kind described in Art 53 of the RAO. (This judgment relates to an application for summary judgment rather than a substantive trial.)

It is important to distinguish between the effect of "disclaimers" for the purposes of determining whether or not advice is being delivered; and whether or not the communicator owes the recipient of the information a duty of care. These are entirely separate issues. In this case, the court did not consider whether or not the "disclaimers" operated to restrict or exclude the company's liability to its customers associated with the provision of the signals. However, it did emphasise that even if they had operated to restrict or exclude liability, this would not have prevented the signals from constituting advice for the purposes of Art 53 of the RAO.

Stay on the right side of the line

While this case focuses on a business model unlikely to be followed by more established financial services firms, it is always important to consider whether the provision of information and recommendations not intended to be provided as advice could be captured by the description in Art 53 of the RAO. If this is a possibility, consideration should be given to either: (i) applying for the appropriate permissions from the FCA; or (ii) discontinuing the service. A bare disclaimer is unlikely to displace the classification of such information as investment advice.

UK retail banking: Building resilience post-pandemic

On 5 February 2021, the Financial Conduct Authority (FCA) published its strategy for the retail banking portfolio. The FCA recognises that the banking industry responded well to the immediate challenges created by COVID-19. Nonetheless, economic conditions are expected to remain difficult over the next two years with the key risks of harm being dominated by the economic and social impact of the pandemic. The FCA identifies four priority areas for retail banks:

- fair treatment of borrowers, especially those in financial difficulties;
- good governance and oversight of customer outcomes during business change;
- operational resilience; and
- minimising fraud and other financial crime.

This article focuses on the key risks associated with operational resilience and reduction of financial crime and the steps banks can take to ensure regulatory compliance whilst enhancing returns.

Operational resilience

Operational resilience has been a priority for regulators for a couple of years now and new risks created by the current economic environment have re-focused this attention. The FCA considers that the level of "incidents and outages" is still too high. The root cause tends to be weaknesses in firms' governance and oversight of operations and technology, especially in relation to change programmes. The regulator is concerned that governance and oversight will be further stretched by the accelerating rate of operational changes required as banks react to meet the changing needs of both customers and their own businesses post-pandemic. The FCA is particularly concerned about:

- increased reliance on third-party suppliers;
- migration of data and systems to the cloud;
- increased traffic through digital/online systems;
- reliance on unprecedented technical innovations;
- capacity challenges in banks' delivery of, and roll-off from, the various government schemes that have been put in place; and
- change programmes aimed at reducing costs and/or exploring new revenue streams.

To guard against these risks crystallising into harms, the FCA expects banks to take the following steps:

- identify, manage and mitigate risks arising from operational disruption, particularly in relation to change and transformation programmes. Good practice examples are highlighted in the FCA's Implementing Technology Change review;
- engage with the FCA ahead of implementing operational and technological changes that could have a significant impact on the bank's risk profile;
- identify and manage operational risks throughout the lifecycle of third-party arrangements;
- if third-party suppliers are not correcting issues or mitigating risks, you should highlight this to the regulator;
- ensure appropriate engagement from the board and senior management;
- ensure board members and senior managers have the necessary knowledge, experience and skills for their responsibilities;
- establish clear lines of responsibility for managing operational resilience, and clearly delegate responsibilities where an important business service is supported by a wide range of people and systems – particular attention on SMF24 individuals; and
- have regard to the FCA's consultation on Building operational resilience: impact tolerances for important business services (no new requirements expected before the end of this year).

Minimising fraud and financial crime

Naturally banks are keen to expand their online presence to meet customer demand; but such expansion can increase the bank's vulnerability to financial crime. Appropriate steps must be taken to mitigate and manage this risk. The current economic climate exposes banks to more pressing and evolving challenges, such as:

- cyber-attacks
- criminals taking advantage of the ever growing population of vulnerable customers
- vulnerable customers being used as accomplices (eg money mules)
- increasing speed and volume of transactions

Banks must make sustained improvements to their systems and controls to adapt to new threats. In particular, the FCA expects firms to:

- ensure continuing adequate investment in well – resourced and capable governance and oversight of financial crime risks;
- make sufficient long-term investment – financial and non-financial – in counter-crime systems to ensure they are effectively spotting, disrupting, stopping and reporting potential financial crime;
- apply the guidance set out in the FCA's guide to countering financial crime risk and cyber insights report; together with the latest JMLSG guidance;
- be prepared to explain the steps the firm has taken in response to the forthcoming Dear CEO letter on AML frameworks – particular attention will be on SMF17s and prescribed responsibility; and
- when conducting its financial crime risk assessments, the bank should consider an overview of risk which the bank is exposed to, including information about emerging risks and any changes to the current risk assessment.

Other than where the FCA conducts targeted engagement with newly identified high-risk firms or is responding to firm notifications, monitoring and advancing these priorities will form part of the overarching supervision of retail banks this year.

In any event, in a post-pandemic world, investing in operational resilience and reducing financial crime is likely to result in positive reputational and financial returns.

Why Diversity and Inclusion are regulatory issues

On 17 March 2021, Nikhil Rathi, the CEO of the Financial Conduct Authority (FCA), gave a speech at the launch of the HM Treasury Women in Finance Charter Annual Review.

The CEO noted that the FCA and the Prudential Regulation Authority are developing a joint approach to Diversity and Inclusion (D&I) for all financial services firms.

Mr Rathi set out some of the broad areas in which the FCA is focusing on D&I in its approach to regulation in the UK.

Holding firms to account

As part of the introduction of the Senior Managers Regime (SMR), the FCA introduced five conduct rules that senior managers must meet. These include obligations to ensure senior managers take "reasonable steps" to ensure the part of the business they manage does not engage in any regulatory breaches.

In the Speech, Mr Rathi said that he would like a sixth rule added for all firms that asks "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?"

Mr Rathi noted that this question is broader than representation. It tests how positive a regulated firm's culture actually is. Relating not just to diversity but inclusion, the imposition of this standard would enable cultural change and empower staff from all different backgrounds to feel confident in speaking up.

According to Mr Rathi, if the FCA does not see improvements in diversity at senior levels, the regulator will consider how best to use its statutory powers. For example, he suggested that considerations of the diversity of a management team and the inclusivity of the management culture they create could be part of the FCA's consideration of Senior Manager applications under the SMR.

Listing rules

Mr Rathi also noted that the FCA is considering whether D&I should be part of the FCA Premium Listing Rules. He noted that many investors and exchanges – such as Nasdaq – are already taking positive steps in considering D&I when it comes to listing and investment. Mr Rathi encouraged all capital markets participants to consider the reasons why there are so few female CEOs and CFOs or CEOs and CFOs of colour presenting during IPOs and whether there are challenges in the culture of private equity, underwriting and equity syndication.

At a broader level, Mr Rathi concluded by noting that poor D&I outcomes result in conduct risks by those firms that fail to reflect society. These firms also fail to serve diverse communities. And, at that point, D&I failings become regulatory issues.

The FCA will increasingly be asking tough questions to regulated firms about representation across grades and whether their culture is open, inclusive and provides a safe space for colleagues at all levels of the organisation.

DLA Piper broader observations

These initiatives form part of a broader movement across society, politics and business to create a more inclusive culture in communities, professions and the public sphere. In light of the increasing focus on Environmental, Social, and Governance (ESG), it is notable that a number of firms have turned their attention to improved portfolio alignment, applying pressure, for example, to improve diversity on boards of investee companies, as well as paying attention to corporate social responsibility. This all makes a great deal of sense, given that there is considerable evidence to highlight improved returns on investment and greater resilience within portfolios that demonstrate stronger D&I metrics. Focusing on such matters in investment activities but failing to reflect these values in-house would be a clear case of "physician, heal thyself." We are already noting an uptick in legal and compliance advisory work in this area, with intense media focus and an active disputes horizon and we expect the regulator to become increasingly engaged as these risks intensify.

PRA consults on implementation of Basel III standards in the UK

On 12 February 2021, the Prudential Regulation Authority (PRA) published Consultation Paper (CP5/21) on the implementation of the Basel III standards into UK law (CP). This is the first major PRA publication after the end of the Brexit transitional period. The draft rules are generally closely aligned (but not identical) to the corresponding requirements under the EU's CRR II.

Stakeholders were able to provide their feedback to the Consultation by Monday, 3 May 2021.

Background

CRR II implements the remaining Basel III standards (which were not covered by the Capital Requirements Regulation (EU) No 575/2013 (CRR)) into EU law. However, given that most of the CRR II provisions come into force on 28 June 2021 (ie after the end of the Brexit transitional period) they have not been transposed into UK law. Instead, the remaining Basel III standards will be implemented into UK law through the Financial Services Bill, which will give the PRA the power to adopt relevant rules.

In general, the PRA has used CRR II as an initial basis for the UK framework, but it is also proposing to take a different approach where this is deemed necessary to achieve closer alignment with the Basel III standards, enhance proportionality of the UK regime and ensure consistency with the existing UK rules. For the most part, the new UK prudential framework will apply from 1 January 2022.

The Consultation does not cover amendments to the UK's leverage ratio regime, which will be considered separately by the Financial Policy Committee (FPC) and Prudential Regulation Committee (PRC).

Overview of key proposals

- **Definition of capital/deduction of software assets from CET1:** A main area of divergence between the EU and the UK concerns the capital treatment of certain software assets. Generally, under the Basel III standards "intangible assets" must be deducted from Common Equity Tier 1 (CET1) capital, on the basis that they are not sufficiently loss absorbent on a going concern basis. The EU CRR II rules exclude certain software assets from the requirement for CET1 deduction. The PRA has previously expressed concerns with the EU approach. Therefore, the draft UK rules require all intangible assets (including software assets that qualify as intangible assets under International Financial Reporting Standard (IFRS) or the applicable accounting standards) to be fully deducted from CET1, with no exception. The PRA intends to implement the relevant changes as soon as possible.
- **Counterparty credit risk:** The PRA proposes a new standardised approach for measuring counterparty credit risk exposures (SA-CCR) for firms that are not permitted to use the internal model method (IMM) and a revised framework for firms' exposures to central counterparties (CCPs). The PRA also proposes a simpler, more conservative SA-CCR approach for certain smaller firms. This forms part of a series of draft measures that aim to make the UK prudential framework more proportionate, particularly for smaller institutions.
- **Market risk:** The Consultation includes changes to the requirements for the trading book, particularly regarding the requirements on prudent valuation. In addition, the PRA proposes amending the eligibility requirements for derogation for small trading book business by increasing the relevant thresholds, thereby allowing more firms with limited trading activities to be exempt from certain market risk requirements. In particular, the PRA proposes replacing the relevant thresholds under the EU CRR with a threshold of 5% of a firm's total assets and an absolute threshold of GBP44 million (which is more than twice as high compared to the current EU absolute threshold).
- **Operational risk:** The draft rules aim to clarify certain ambiguities that have been identified regarding the method of calculation used for the basic indicator approach (BIA), in particular by making explicit the treatment of leasing assets.
- **Large exposures:** The CP implements the Basel III standards' revised large exposures framework, which will generally be aligned to the CRR II relevant framework.

- **Liquidity rules:** In addition to implementing the Basel III standards on the Net Stable Funding Ratio (NSFR), the draft rules introduce a simplified (but at least as conservative) version of the NSFR that small and non-complex firms may choose to apply. With regards to the Liquidity Coverage Ratio (LCR), the PRA intends to replicate the relevant requirements under the CRR and the relevant Delegated Acts into the PRA rules, but also clarify certain definitions.
- **Exposures to Collective Investment Undertakings (CIUs):** The draft rules revise the prudential requirements applicable to CIU exposures by introducing an updated hierarchy of approaches to determine relevant capital requirements: (i) a revised look through approach (LTA), that can be used where a firm has sufficient information on the underlying exposures of the CIU, and the information is verified by a third party; (ii) a mandate based approach (MBA); and (iii) a fall back approach (FBA) which can be used when the LTA and MBA are not feasible and under which a 1,250% risk weight would apply. The PRA intends to allow firms to apply a combination of the three approaches to their CIU exposures, provided the relevant conditions for their use are met.
- **Currency denomination of thresholds and monetary values:** As a general rule, the PRA intends to redenominate thresholds and monetary values included in the proposed PRA rules from euros (EUR) into pound sterling (GBP) (with the exception of the thresholds for disclosure of the number individuals that receive remuneration of EUR1 million or more per financial year).
- **Updates to supervisory reporting:** Among other things, the PRA proposes updating the UK version of COREP and FINREP and intends to use as basis version 3.0 of the European Banking Authority's (EBA) reporting taxonomy, which has also been updated recently in light of the Basel III standards.
- **Pillar 3 disclosure:** The relevant proposals aim to align the Pillar 3 disclosures of UK firms to the relevant Basel III requirements and improve the comparability, quality, and consistency of firms' regulatory disclosures.

EU

The transformation of payments: Proposed EU-wide Instant Payments Scheme

On 11 March 2021, the European Commission (Commission) published for consultation a Draft Roadmap on the development of an EU-wide instant payments scheme.

The Objectives of a pan-European Instant Payment Scheme

According to the Impact Statement accompanying the Draft Roadmap, instant payments have the potential to become a vehicle for EU payment service providers (PSPs) to offer successful, pan-European payment services. The European Commission's intention is to offer consumers an alternative to incumbent payments market participants, with a focus on facilitating competition. The European Commission considers that such services, if offered and accepted globally, could contribute to the strengthening of the international role of the euro.

The Draft Roadmap allows industry to input their ideas and recommendations to the Commission as it advances towards the development of a pan-European Instant Payments scheme. The Commission notes that a pan-EU instant payment scheme would reduce costs for merchants in terms of lowering price compared to alternative payment methods, such as cards. It would also provide savings to corporates in terms of managing their cash flows.

Consumers, as users of payment services, would also benefit by having access to a safe, convenient and modern payment system. The Commission states in the Impact Statement that a pan European Instant Payment scheme may also lower prices of goods and services if the savings generated for merchants were to be passed through to consumers. Instant payments, coupled with new and existing fintech solutions such as mobile apps and wearables, using an adapted payment acceptance infrastructure, will contribute to further digitalisation of payments in the EU.

Timing and next steps

The consultation closed on 7 April 2021.

The responses received will feed into how the Commission will develop and fine tune the EU-wide faster payments initiative. The Commission plans to adopt a proposal in quarter 1 of 2022.

Objectives

The Draft Roadmap identifies the Commission's key Objectives and Policy Options.

The goal is to foster pan-European market initiatives based on instant payments to ensure anyone holding a payment account in the EU can receive and send an instant credit transfer from and to any other payment account.

This pan-European faster payments initiative is consistent with the Single Euro Payments Area (SEPA) project, and also complements the Commission's consultation on a retail payment strategy.

The Commission will carry out an Impact Assessment on various policy options (or a combination of them) as set out below:

- The baseline option which involves monitoring the market evolution and assessing the effects of voluntary efforts to foster the full take-up of instant payments in the EU.
- A non-legislative option which would involve actively promoting voluntary participation of payment service providers (PSPs) in standardisation processes/ schemes, awareness raising campaigns for payments services users, coordinating national plans for promoting the uptake of instant payments across the EU etc.
- Legislative options which could cover a mixture of possible "enabling measures." These could include:
  - effective incentives for PSPs to offer instant credit transfers in EUR;

- initiatives similar to that of the SEPA Regulation (eg exploring issues regarding fee structures for SEPA Instant Credit Transfer-based payment solutions, supporting interoperability of SEPA Instant Credit Transfer-based payment solutions and schemes etc);
- developing targeted consumer protection measures and tailored fraud prevention measures;
- addressing issues of charges levied on consumers for instant credit transfers; reconciling instant payments with regulatory compliance obligations;
- ensuring sound mitigation measures on liquidity risk;
- exploring management framework for financial institutions;
- ensuring transparency and choice of payment options; and
- supporting technical standardisation led by industry.

Public consultation on instant payments

Following on from the targeted consultation on the Draft Roadmap, the next stage of the EU's Retail Payments Strategy is a wider public consultation on remaining obstacles to pan-European instant payments. This consultation will alert the Commission to general steps it could take to increase the availability and use of instant payments across Europe. It will also give some insight as to whether specific policy measures are needed to ensure that a sufficient number of EU PSPs start offering instant credit transfers.

The main aim of the consultation is to identify market concerns around instant credit transfers, ultimately with a view to alleviating such concerns and incentivising EU payments market players to offer innovative, convenient, safe and cost efficient pan – European payment solutions based on this technology. In addition, the consultation will help the Commission to establish what features and safeguards should be put in place to maximise the benefits of instant payments for service users.

Topics for consultation include:

- the preferences of consumers, merchants and corporate users relating to instant credit transfers
- the views of payment service providers (PSPs) on instant credit transfers
- technical standardisation, such as the introduction of a single European QR code standard for instant credit transfers

The deadline for responses was 23 June 2021.

EU Retail Payments Strategy – the journey continues: Conclusions adopted by Council of EU

On 22 March 2021, the Council of the EU published an outcome of proceedings (7225/21), setting out its conclusions on the Commission's communication for the further development of the retail payments market in the EU.

New initiatives and PSD2 review

The Council fully supports the overall aims of the strategy and approves the Commission's plans. The Council's endorsement is an important milestone in the development and execution of the new Retail Payments Strategy. It will allow the Commission to push forward initiatives across the retail payments field and to present legislative proposals. In particular, the Commission now has the Council's support for a comprehensive review of the payments services directive (PSD2), including an EU view on open banking.

Challenges

The conclusions identify the following general challenges to further developing and regulating the retail payments market:

- financial inclusion
- security and consumer protection
- competition
- data protection
- anti money laundering aspects
- anti-terrorism

Four key pillars

Several conclusions specific to the four key pillars in the Commission's communication are also set out in the outcome of proceedings:

PILLAR 1: INCREASINGLY DIGITAL AND INSTANT PAYMENT SOLUTIONS

The Council:

- agrees that legislation may be needed to promote uptake of the SEPA Instant Credit Transfer (SCT Inst.) scheme and its additional functionalities (eg requests to pay QR codes and proxy lookup services). It suggests that other ways to foster its adoption could also be explored;
- agrees that National Competent Authorities should swiftly investigate and remedy breaches of the SEPA Regulation; and
- agrees that a study should be conducted as to the level of acceptance of digital payments before any possible legislative proposal is developed to increase them.

You can read more on instant payment proposals elsewhere in this publication.

PILLAR 2: INNOVATION AND COMPETITIVENESS ISSUES (PSD2 REVIEW)

The Council welcomes a comprehensive review of the implementation of the Payment Services Directive 2 (PSD2) which takes account of the developments in the market and the challenges encountered in its implementation, and in particular:

- how appropriate the PSD2's scope is, and the need for further clarification of existing concepts and rules;
- PSD2's interplay with the E-money Directive, the Anti-money laundering Directive and the GDPR;
- the evolution to open banking, and associated privacy risks;
- PSD2's impact on competition; and
- how effective PSD2 is at limiting fraud and enhancing consumer protection.

PILLAR 3: ACCESS AND INTEROPERABILITY ASPECTS

The Council:

- supports an extension of the scope of the Settlement Finality Directive (SFD) to include e-money and payment institutions, providing that the potential risks are carefully assessed and adequately mitigated;
- agrees that legislative action should be taken to secure a right of access, under fair, reasonable and non-discriminatory conditions, to technical infrastructures that are considered necessary to support the provision of payment services such as near field communications (NFC).

PILLAR 4: THE INTERNATIONAL DIMENSION

The Council:

- supports efforts to facilitate linkages to third-country jurisdictions, assuming that they meet requirements for consumer protection, fraud prevention, AML/CFT and GDPR compliance;
- encourages the adoption of the ISO 2022 global standard to facilitate the inclusion of richer data in payment messages;
- supports public and private initiatives in various Member States leading to faster, cheaper and more convenient remittances; and
- asks the Commission to promote access to payment accounts and globally interoperable payment solutions in low and middle income countries (within the framework of EU development policy).

Deferral of final implementation phases of the margin requirements for non-centrally cleared derivatives

In Spring 2020, the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) announced that they agreed, in response to the COVID-19 pandemic, to extend the deadline for completing the final implementation phases of the margin requirements for non-centrally cleared derivatives. Accordingly, the three European supervisory authorities (ESAs) published a draft amendment to the European delegated regulation on risk-mitigation techniques (Margin Regulation) to implement such deferral.

The Commission Delegated Regulation (EU) 2021/236 of 21 December 2020, which amends the Margin Regulation in regards of the timing of when certain risk management procedures will start to apply, for the purpose of the exchange of collateral, was published in the Official Journal of the EU on 17 February 2021.

As a consequence of the European Commission endorsing the ESA's draft amendment without modifying it, the last two phases of implementation of the initial margin requirements will take effect on the following dates (depending on the volume of non-cleared derivatives traded):

- From 1 September 2021, where the counterparties (or their respective group) have an aggregate average notional amount (AANA) of non-centrally cleared derivatives above EUR50 billion, it's noted that this threshold was not included in the initial timetable.
- From 1 September 2022, where the counterparties (or their respective group) have an AANA of non-centrally cleared derivatives above EUR8 billion, the period is being extended by one year.

ESMA warns of risks to retail investors of social media driven share trading

On 17 February 2021, the European Securities and Markets Authority (ESMA) published a statement to highlight to retail investors the risks connected to trading decisions exclusively based on the exchange of views, informal recommendations and sharing of trading intentions through social networks and unregulated online platforms.

High volatility in the trading of certain stocks

In the statement, ESMA referenced the high volatility in certain US-listed stocks connected to significant short positions and the concerted efforts by some retail investors to purchase these stocks. Social media was used by some of these retail investors in communicating their trading strategies and in making recommendations to other retail investors.

ESMA does not name particular stocks in the statement but it is highly likely that ESMA is referring to trading in the US-listed shares of GameStop (and others) which were subject to considerable trading volatility in January/February 2021. This particular trading has largely been reported to have been coordinated via a Reddit forum called r/WallStreetBets, where amateur retail investors highlight their trading strategies and urge coordinated action against institutional investors who may have short positions in certain companies which they must cover.

According to ESMA, although market rules and structures are different in the EU, "it cannot be ruled out that similar circumstances may occur in the EU as well."

ESMA's message to retail investors

While increased retail investors participation is a welcome development in the Capital Markets Union, ESMA cautions these investors to be careful when taking investment decisions based exclusively on information from social media and other unregulated online platforms if they cannot verify the reliability and quality of that information.

In the statement, ESMA reminds retail investors of the importance of gathering information from reliable sources, setting and working towards investment objectives and the benefits of diversification.

ESMA also reminded investors that the use of leverage amplifies risks in the context of significant price volatility. ESMA stresses that trading with leverage is complex and should be entered into with a full understanding of the risks.

Market abuse

The US trading has raised concerns about the employment of the market manipulation technique of a "short squeeze."

In the statement, ESMA notes that discussing the opportunity to buy or sell shares does not constitute market abuse. Conversely, organising coordinated strategies to trade or place orders at certain conditions and times to move a share's price may constitute market manipulation. Retail investors therefore should take special care when disseminating investment recommendations through any media, including social media.

ESMA and EU national competent authorities will continue to analyse market events and may consider further initiatives to preserve investor protection and market integrity going forward.

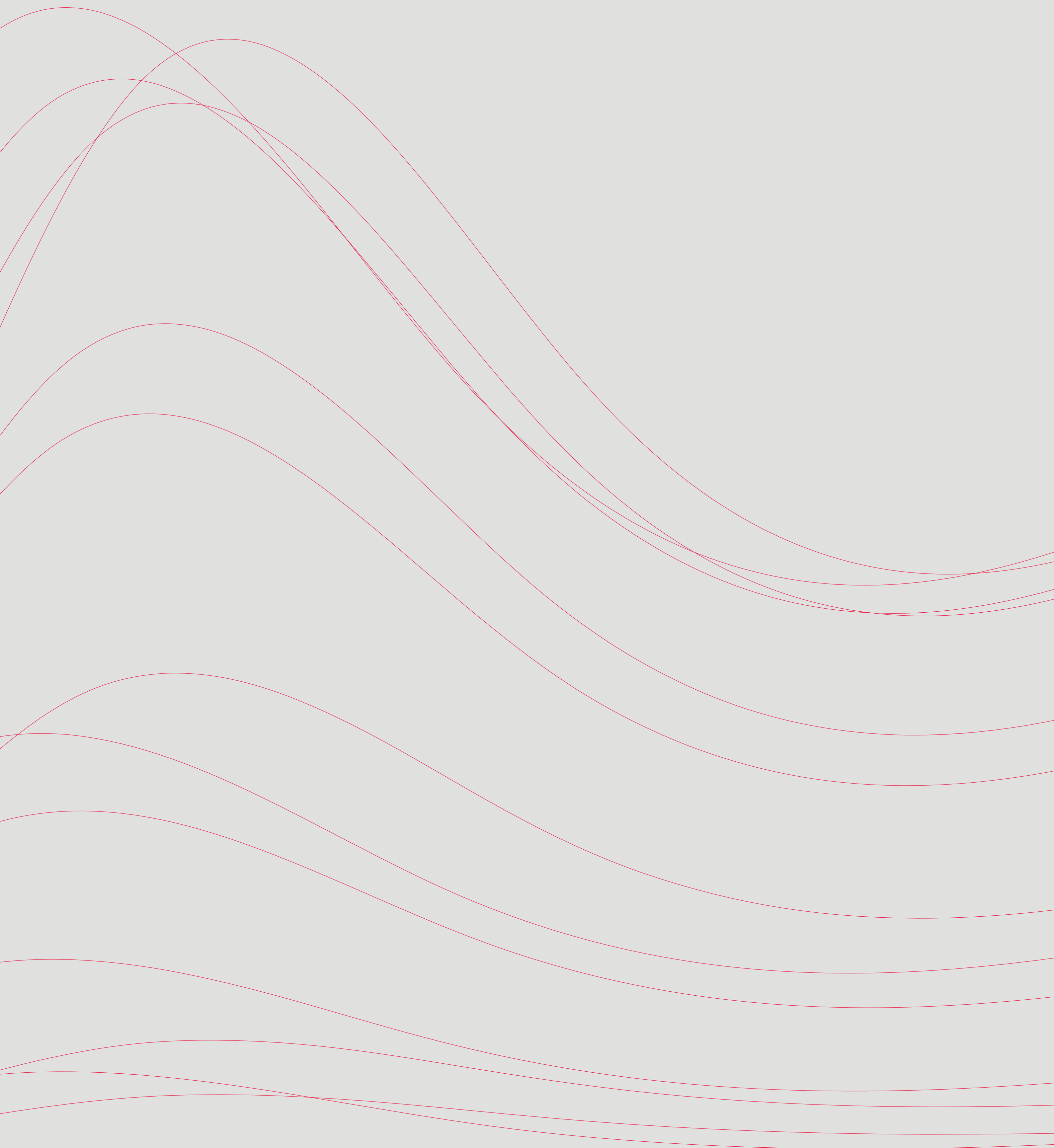
UK Financial Conduct Authority statement

The ESMA statement follows a statement from the UK Financial Conduct Authority (FCA) on 29 January 2021. This FCA statement reminds investors that buying shares in volatile markets is risky and that investors may quickly lose money.

The FCA statement also notes that broking firms are not obliged to offer trading facilities to clients. They may withdraw their services, in line with customer terms and conditions if, for instance, they consider it necessary or prudent to do so. Firms are exposed to greater risk and therefore more likely to need to take such action during periods of abnormally high transaction volumes and price volatility.

This FCA statement on broker autonomy may be seen as a response to the reaction of the US broking firm, Robinhood, banning certain investors from the use of its broking services in connection with the trading of the shares of GameStop and other US-listed shares.

The FCA statement concludes that the FCA will take appropriate action wherever the FCA finds evidence of firms or individuals causing harm to consumers or markets.



Germany

Introduction of Electronic Fund Shares in Germany

On 16 December 2020, the German Federal Cabinet adopted the draft law on the introduction of electronic securities (*Gesetz zur Einführung von elektronischen Wertpapieren* – eWpG) jointly submitted by the Federal Ministry of Finance (*Bundesfinanzministerium* – BMF) and the Federal Ministry of Justice and Consumer Protection (*Bundesministerium für Justiz und Verbraucherschutz* – BMJV). The aim of the new law is to modernise the securities law and thus strengthen Germany as a financial centre, especially in the field of digitisation.

The new law will enable the issuance of German-law securities in purely electronic form without the requirement for a physical security. It also allows the issuance of crypto securities enabling the implementation of distributed ledger technology-based instruments. The original scope of the draft law (*Referentenentwurf* dated 11 August 2020) provided for an exclusive application to bearer bonds (*Inhaberschuldverschreibungen*). Electronic shares of a corporate nature, eg stock, are out of scope due to further required work on the corporate law implications, but the scope may be widened accordingly at a later stage.

In addition to the introduction of electronic securities in the form of bearer bonds, the new draft as of 16 December 2020 contains a proposed amendment to the German Capital Investment Code (*Kapitalanlagesetzbuch* – KAGB) to the effect that share certificates (*Anteilscheine*) of German investment funds in the contractual form of Sondervermögen, that do not have legal personality, (*elektronische Anteilscheine* – electronic fund shares) can also be issued in electronic form. According to the draft law, electronic fund shares may only be registered in bearer form.

The new law does not foresee the possibility to issue electronic fund shares in the form of crypto securities according to the eWpG. Shares in investment funds of a corporate type such as those of a German investment stock corporation (*Investmentaktiengesellschaft*) or investment limited partnership (*Investmentkommanditgesellschaft*) also remain out of scope.

To implement electronic fund shares, certain provisions relating to electronic securities within the ambit of the eWpG shall apply *mutatis mutandis* according to an amendment of Sec. 93 Capital Investment Code. The rules concerning electronic securities as stipulated in the eWpG shall apply to electronic fund shares in a manner that the provisions of the eWpG relating to electronic securities shall be construed to refer to electronic fund shares, those relating to the terms and conditions of the securities shall be read to refer to the fund rules (*Anlagebedingungen*) and those relating to the bearer shall relate to the investor.

According to the corresponding references to the eWpG electronic fund shares:

- must be registered in a central electronic securities register (*zentrales elektronisches Wertpapierregister*) as an issuing mechanism which is operated by a duly authorised central securities depositary or a nominated depositary subject to technical security and data compliance standards; and
- have fundamentally the same legal status as a paper security and are deemed a physical (in rem) instrument.

Because – as regards investor transparency – the fund terms are governed by the provisions of the Capital Investment Code, there is no requirement that these are also filed – and thus available to the public (*Niederlegung*) with the central electronic securities register.

The proposed introduction of electronic fund shares is a welcome step to foster the digitisation of the German capital market. Fund shares of Sondervermögen are a common retail investment product and also the standard institutional investment fund (Spezial-AIF) is set up in this format. In its submission to the consultation of the draft law, the German Alternative Investment Association (BAI) proposed the introduction of this new electronic financial instrument.

Ireland

CBI focus on diversity and inclusion continues: Publication of CBI Demographic Analysis Report for 2020

The negative effects of groupthink on the Irish financial services sector is back in the spotlight, with public attention again focussed on governance and culture in financial institutions and a question mark over what has changed since the financial crisis. However, for the Central Bank of Ireland (CBI), focus on the interplay between lack of diversity and increase in risk has never gone away. In fact, diversity and inclusion in regulated firms has been an increased focus of the regulator for the last few years. As the CBI said in its most recent Dear CEO letter, it is "placing a spotlight on this issue, and intend to keep it there."

For the regulator, there is a direct correlation between a lack of diversity at senior and executive level and increased risk of poor decision-making and bad risk management, the rationale being that increased diversity protects against overconfidence and encourages internal challenge.

In 2018, the CBI published a report on the Behaviour and Culture of the Irish Retail Banking Sector, which found that more work was required in ensuring the industry was sufficiently diverse and inclusive. Following on from the retail banking review, in July 2020, the CBI published a thematic assessment of diversity and inclusion in insurance firms. In that report the CBI concluded that there was a lack of sufficient progress by insurance companies on improving diversity and inclusion, which gave rise to regulatory risks.

In the Compliance Files podcast, Seána Cunningham, Director of Enforcement and Anti-Money Laundering at the CBI, said that senior leaders have to provide clarity of direction on their vision for D&I and how it is aligned to the strategic direction of the business, with at least a detailed annual discussion by the Board and regular discussions at an executive level.

For the last five years, the CBI has also provided updates on the levels of diversity of senior appointments at regulated firms. The Demographic Analysis report for 2020 (the 2020 Report), published in March 2021, examined 3,600 applications to the CBI for approval to occupy pre-approved control function (PCF) roles in senior management and, or board level roles within certain regulated firms. The 2020 Report focuses primarily on gender diversity and also touches on age and nationality profiles of applicants. That diversity extends beyond gender, age and nationality is expressly acknowledged by the CBI.

Just over one in four applications for regulated firms were from women. While this is an increase from about one in six of the applications received for such roles in 2012 (the first year such an analysis was carried out), it is an increase from a low base with "little overall change" in 2020 relative to 2019.

Female applications for board level positions fell to 22% in 2020, down from 24% in 2019, with the 2020 Report highlighting a "pronounced gender imbalance" at board level across all sectors. 84% of role holders in business revenue and strategy roles were also male.

Interestingly, existing regulated firms show higher levels of gender diversity than new firms seeking authorisation, with a ratio of four to one in terms of male vs female applicants for new firm authorisations – what the CBI has deemed a "material imbalance." Men also hold 85% of current PCF positions in the asset management sector, 78% in the banking sector and 74% in the insurance sector.

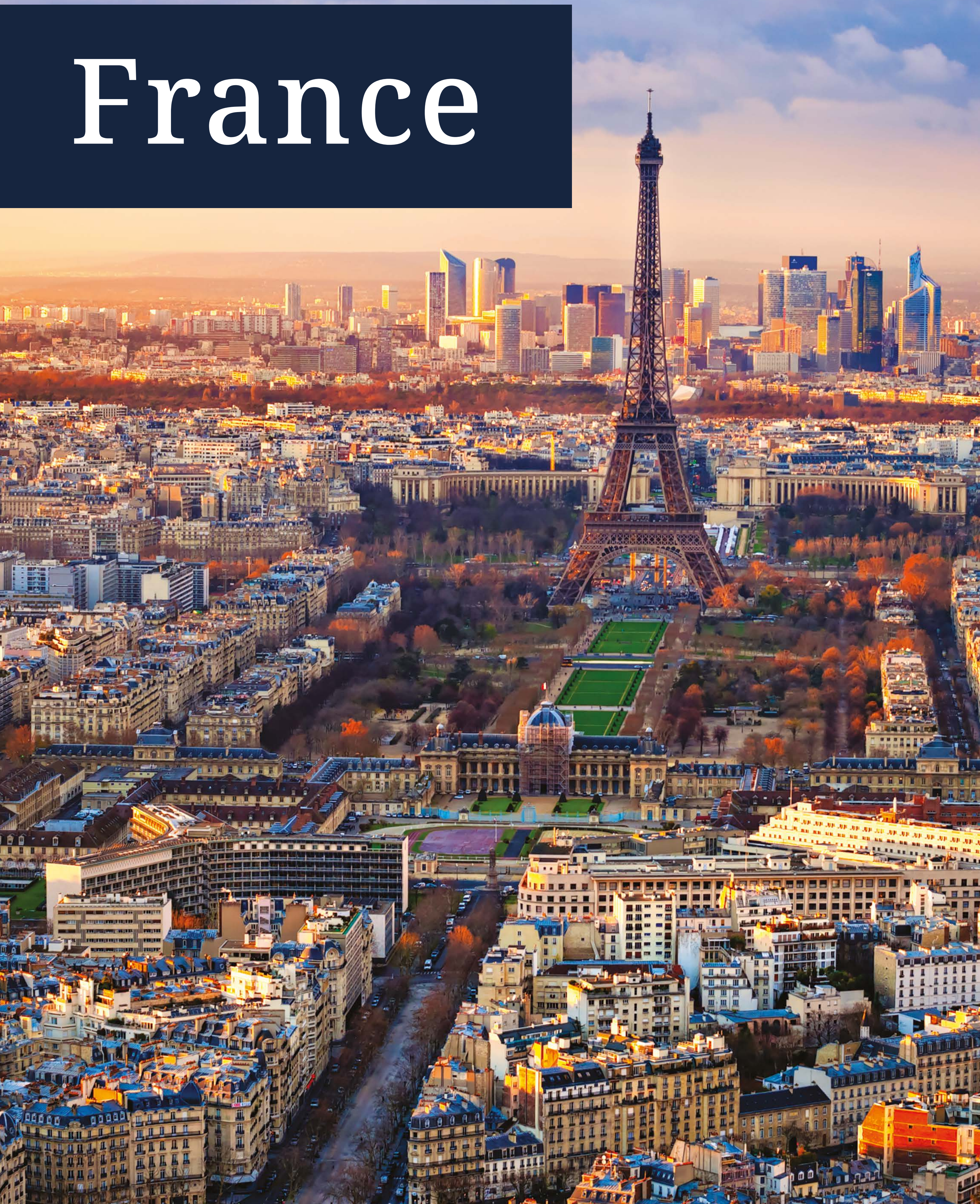
The 2020 Report also looked at nationality and age diversity, with the majority of applicants for PCF roles being Irish (64%), with UK nationals being the second largest cohort of applicants (16%). Over two-thirds of applicants were in the age bracket 35-54 years of age. At board level, almost three-quarters of applicants were above the age of 45, with men in the 45-54 age range representing over one-third of executive directorship and chief executive applications.

The 2020 Report directly references the fact that diversity and corporate culture are environmental, social and governance (ESG) factors. Public consciousness of ESG has rapidly increased, no doubt

expediated by the COVID-19 pandemic, the Black Lives Matter and Me Too movements, with ESG issues quickly rising up the agenda not just for regulators but for governments, investors and individuals. This means that diversity across the spectrum is not a challenge unique to the financial services sector but is an increasingly important consideration for leadership across sectors who are conscious of the fact that ESG is the new means through which companies will be evaluated and measured. Edelman's most recent Investor Trust research shows that investors believe companies that excel in ESG merit a premium valuation of their share price, with "social" now ranking as the most important element for investors. It also showed that diversity and inclusion screening is now used by seven out of ten investors, including for board diversity.

An opportunity exists for companies to not only ensure compliance with their CBI obligations but also to develop ESG initiatives that can set them apart. With developments expected in 2021 on the proposed Senior Executive Accountability Regime, this area is likely to remain towards the top of the CBI's agenda for the foreseeable future – in fact the CBI has a specialist team conducting D&I assessments across sectors.

France



Key takeaways from the French financial markets authority 2020 annual report

The French financial markets authority (*Autorité des marchés financiers*, AMF) has published its annual report, which considers its actions during the pandemic – such as the use, for the first time, of its power to ban net short positions. The AMF annual report also identifies various key areas for economic recovery.

In 2020 stock market transactions by individuals in France reached 60 million, a 35 million increase year on year. Hence, the AMF pointed out that it had become essential to ensure a safe framework, limiting excessive risk-taking. To that end, the AMF conducted a series of inspections summarised in a publication dated March 2021. Those short thematic inspections focused on the suitability of the products recommended to clients based on their profile.

Defending market integrity and ensuring shareholder dialogue were top priorities for the AMF, as they appear essential to achieve transparency – especially in relation to listed companies – and prevent market abuse. In addition, the AMF participated in the adaptation of rules on annual general meetings, which were greatly affected by the pandemic. In this context, it published recommendations on that topic in which it was openly supportive of live electronic voting in annual general meetings. However, certain French issuers showed reluctance towards the prospect, unlike other European issuers.

The development and support of sustainable finance remained a top priority for the AMF, in spite of the pandemic. On this topic, some of its measures included the publication of a first doctrine on the marketing of collective investment products incorporating non-financial approaches to avoid greenwashing, and the drafting of the first report on the monitoring and evaluation of the climate commitments, jointly with the French banking authority (*Autorité de contrôle prudentiel et de résolution*, the ACPR). The AMF was also involved at European level, contributing to consultations on several matters, including its renewed sustainable finance strategy. The AMF's involvement in sustainable finance is expected to keep growing as new European regulations apply from this year, such as the regulation (EU) 2019/2088 of 27 November 2019 on sustainability and related disclosures in the financial services sector (SFDR) and the Regulation (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment (Taxonomy).

The upcoming French Presidency of the Council of the EU in 2022 will bring the enhancement of the financial sovereignty of the EU at the centre of the AMF's priorities. While the Capital Markets Union is stagnating, in September 2020 the European Commission presented an action plan aimed at fostering the access of companies to market financing, promoting European investors' access to secure long-term products, and closer integration of the 27 national markets of the European single market.

Transposition of CRD V relating to credit institutions' authorisation and prudential supervision

France continues the transposition of Directive (EU) 2019/878 (the Capital Requirements Directive, CRD V) into its legal system, and adopted two administrative orders (*arrêtés*) on 25 February 2021, relating to (i) the authorisation, changes in status and withdrawal of authorisation of credit institutions (and French finance companies, payment institutions and electronic money institutions – the Authorisation Order) and to (ii) prudential supervision on a consolidated basis (the Prudential Supervision Order). The orders were published in the French official journal on 6 March 2021.

Modifications relating to credit institutions' authorisation

The Authorisation Order aims at modifying existing rules resulting from EU regulations, implemented into French law by two administrative orders dated 4 December 2017. The two main changes thereby implemented into French law are the following:

- in addition to the capital providers' identity, entities applying for a credit institution authorisation should also evidence the appropriateness of said capital providers, on the basis of the following criteria, listed by article R. 511-3-2 of the French monetary and financial Code:
    - the good repute of the capital providers;
    - compliance with French requirements on good repute, knowledge, skills and experience of the managers;
    - the financial soundness of the capital providers;
    - the ability of the credit institution to comply and continue to comply with its prudential obligations; and
    - the existence of reasonable grounds to suspect that a money laundering or terrorist financing operation or attempt is being or has been carried out.
- in the event of a simultaneous (i) approval procedure of a financial holding company, a mixed financial holding company or the parent undertaking of a finance company and (ii) acquisition procedure by such entity of a credit institution, the latter procedure shall be suspended for a minimum of 20 business days or until the completion of the former approval procedure.

Modifications relating to credit institutions' prudential supervision

The Prudential Supervision Order amended two existing orders, dated 3 November 2014, relating respectively to prudential supervision on a consolidated basis and to prudential supervision and risk assessment processes for banking services providers and investment firms other than portfolio management companies.

Firstly, the Prudential Supervision Order modified existing rules on competence of the French banking Authority (*Autorité de contrôle prudentiel et de résolution*, the ACPR) to supervise, on a consolidated basis, credit institutions and/or investment firms authorised in different EU/European Economic Area Member States having the same parent (mixed) financial holding company established in a EU Member State: the ACPR is now competent when it is the competent authority of:

- the credit institution where it is the only credit institution within the group;
- the credit institution with the largest balance sheet total, where there is more than one credit institution within the group; or
- the investment firm with the largest balance sheet total, where there is no credit institution in the group.

As regards prudential supervision and risk assessment process, the Prudential Supervision Order introduced several modifications, relating to the requirement, for the ACPR, to use a proportionality approach when controlling and assessing compliance, by credit institutions, with capital requirements obligations arising from regulation (EU) no 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms, as amended (CRR), and to inform the European Banking Authority (EBA) when suspecting a money laundering or terrorist financing operation or attempt. The Prudential Supervision Order also modified the scope of the controls conducted by the ACPR, the methods used and the scope of the specific recommendations made by the ACPR to a specific entity in relation additional own funds requirements.

Spain

New cryptoasset rules introduced in Spain

Spain has recently seen interesting developments regarding the regulation of cryptoassets. This article provides an overview of those developments and how they may affect market participants, both domestic and foreign.

By way of background, the issuance, sale and purchase of crypto-currencies and/or other crypto-assets is not a regulated activity in Spain, to the extent such crypto-assets do not qualify as financial instruments, in which case the relevant Prospectus Regulation and MiFID rules would apply.

The European Commission recently published a draft European Regulation on crypto-assets (MiCA) which is currently under discussion.

However, reality is going faster than regulation and we have seen in recent months in Spain a significant increase in the advertising of crypto-assets, including crypto-currencies and other assets using Distributed Ledger Technology (DLT) targeted at Spanish resident investors.

To protect potential Spanish investors from the risks linked to crypto-assets, in March 2021 the Spanish government approved a new Royal Decree-Law which amends the Spanish Securities Markets Law. The key issue of this amendment is that the CNMV (the Spanish investment services and securities regulator) is appointed as the competent authority for the supervision of the advertising of crypto-assets or other assets and instruments that are presented to the public as an investment opportunity, even if they are not activities or products subject to regulation and/or supervision in Spain.

On 5 April 2021, the CNMV issued a public consultation to prepare the regulations on crypto-assets advertising. The main points of the CNMV consultation are the following:

- The scope of the rules – subjective, including Spanish and foreign entities advertising crypto-assets to Spanish resident investors; objective, excluding from the scope of the advertising materials formal documentation, such as "white papers," analysis and reports to professional investors, and excluding from the scope of crypto-assets non-fungible assets, and assets used as a means of payment.
- The type and content of control and supervision. The CNMV is considering if prior authorisation and/or notification should be required for certain mass-market advertising campaigns, and is likely to require mandatory disclaimers that should be included in such marketing materials.

In addition, Spain finally implemented the EU Fifth Anti-Money Laundering Directive (5AMLD) on 27 April 2021. As a consequence of the implementation of 5AMLD in Spain (i) providers engaged in exchange services between virtual currencies and fiduciary currencies; and (ii) custodian wallet providers, become subject to the Spanish AML regulatory framework. In addition, both crypto exchange providers and custodian wallet providers that offer their services to Spanish residents need to be registered with the Bank of Spain. It is worth mentioning that this requirement is applicable not only to Spanish crypto service providers, but also to foreign providers targeting their services to Spanish resident clients.

Moreover, the Spanish Ministry of Economic Affairs published a draft of new securities markets law on 4 May 2021. In the draft, in anticipation to the future EU framework on markets in crypto-assets (MiCA) as well as on the tokenisation of traditional financial assets and wider use of distributed ledger technology (DLT) in financial services, it is explicitly recognised that a financial instrument can be issued using DLT (ie security token).

Finally, the Spanish securities regulator, the CNMV, is providing further guidance in this field. On 7 May 2021, the CNMV updated its Q&A on funds and has included specific answers on the possibility of investments funds to have indirect exposure to cryptocurrencies. For hedge funds, such indirect exposure to cryptocurrencies can be through derivatives, provided that settlement does not entail delivery of the cryptocurrency. In any event, investment funds must include expressly specific information on the underlying investment in the prospectus and the KIID and an express and prominent mention of the exposure and the risks such investment may entail.

China

New data lifecycle guidelines for financial institutions in China

Important new guidelines outlining how personal and other types of financial information should be handled by financial institutions throughout the data lifecycle have just come into force in China, including a new data localisation obligation. The Financial Data Lifecycle Guidelines (金融数据生命周期安全规范) were published by the PBOC – the PRC banking regulator – and came into force on 8 April 2021.

This introduces a data lifecycle security framework, and represents the key guideline for handling personal and other financial information by financial institutions – ie similar to the PIS Specification, but focused on the banking and financial services industry. Key compliance obligations include:

Classification of financial data

The data lifecycle framework introduces five levels of financial data, namely:

- Level 1: public data
- Level 2: basic information about businesses
- Level 3: personal financial information
- Level 4: payments data
- Level 5: important data

Different compliance obligations – relating to data collection, use, storage, transfer, deletion and general security ie throughout the lifecycle of the data – are specified for each level of data. In practice this will require financial institutions to assess and classify/tag financial data against the five levels, and apply the relevant compliance obligations to each level accordingly. This could be a substantial task for some financial institutions.

While there is some alignment between more general PRC regulations governing data categories, such as personal data, these guidelines introduce additional compliance obligations on financial institutions. That is, as regards personal information, financial institutions must now comply with these extra steps as well as the compliance obligations under the PRC Cybersecurity Law, PIS Specification, Draft PIPL etc. For example, apps and web terminals operated by financial institutions must not retain any information at level 3 or above once the transaction in question is concluded.

Data localisation

Level 5 data – ie "important data," not defined in this guideline – must only be stored in Mainland China, and cannot be transferred or accessed outside of Mainland China. Obviously this could involve significant effort and cost if such data is not currently stored purely in China.

For all other financial data (levels 1 to 4), the general principal is that such data should be stored in Mainland China. This appears to be more of a general policy statement rather than strict data localisation requirement. It appears to suggest that, for example with regard to personal information, compliance with overseas data transfer rules under the PIS Specification or Draft PIPL may still allow overseas access and transfer of personal information by financial institutions provided the necessary compliance steps (consent, DPIA etc) are fulfilled. However, we await guidance on how this statement should be interpreted.

Transfer of financial data to third parties

Financial data at level 3 or above – which includes all customer personal information – can only be transferred to, or accessed by, third parties (onshore or offshore) if: (i) necessary for business purposes; and (ii) (in some circumstances) prior approvals are obtained. This reinforces the existing obligations when appointing service providers to:

- conduct DPIAs; put in place data processor agreements;
- apply encryption and other key security safeguards; and
- liaise with the regulators when outsourcing processing of personal and other more sensitive information.

Transfers to group companies are also regulated, and different requirements apply to each level of data.

Extensive security measures

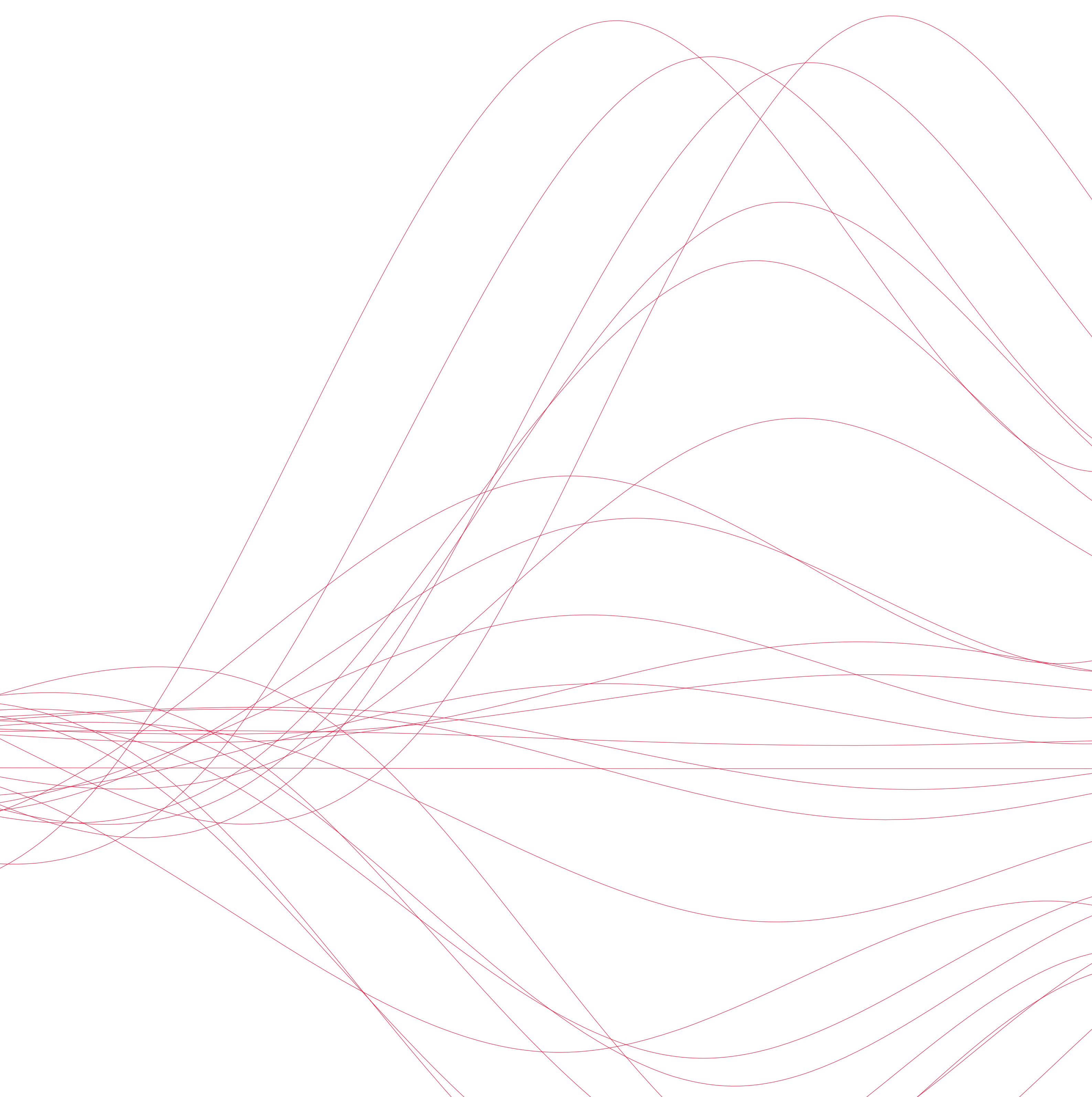
The guideline details extensive data security measures that must be applied throughout the data lifecycle for each level of data. In practice information/data security teams will need to review the new measures and align existing security programmes against them.

Security impact assessment when acquiring data

Financial institutions must undertake an additional data security impact assessment if they acquire any data from an external (third-party) supplier.

Data deidentification (anonymisation)

Detailed steps and examples are provided to help financial institutions to deidentify personal information. More broadly, draft TC260 deidentification technical standards have just been published to help organisations (not just financial institutions) assess the effectiveness of various deidentification methods.



US

Fed proposes guidelines that could allow fintechs to qualify for accounts and payments services

The Federal Reserve (Fed) has proposed new guidelines for what types of financial institutions can have access to accounts and payment services. The Proposed Guidelines for Evaluating Account and Services Requests, unanimously approved by the Fed's Board of Governors on 4 May 2021, invites public comment on Account Access Guidelines to be used by Reserve Banks in evaluating requests for Fed accounts and financial services. An 28 April Fed staff memo to the Board of Governors notes that the introduction of new financial products and novel types of banking charters has compelled the central bank to review its legacy payment operations. While the documents do not use the term "fintech" per se, the Fed's 5 May announcement refers to the recent "introduction of new financial products and delivery mechanisms for traditional banking services, notably leveraging emerging technologies, including from institutions with novel types of banking charters designed to support such innovation." It is noted that the Office of the Comptroller of the Currency's (OCC) proposed special purpose national bank charter, commonly known as the "fintech charter," is under legal challenge by state regulators. Fintech companies looking at either the OCC charter or novel charters at the state level are at the same time considering becoming part of the Fed payments system, which would give them the ability to transfer money without going through a bank.

"With technology driving rapid change in the payments landscape, the proposed Account Access Guidelines would ensure requests for access to the Federal Reserve payments system from novel institutions are evaluated in a consistent and transparent manner that promotes a safe, efficient, inclusive, and innovative payment system, consumer protection, and the safety and soundness of the banking system," said Federal Reserve Board Governor Lael Brainard.

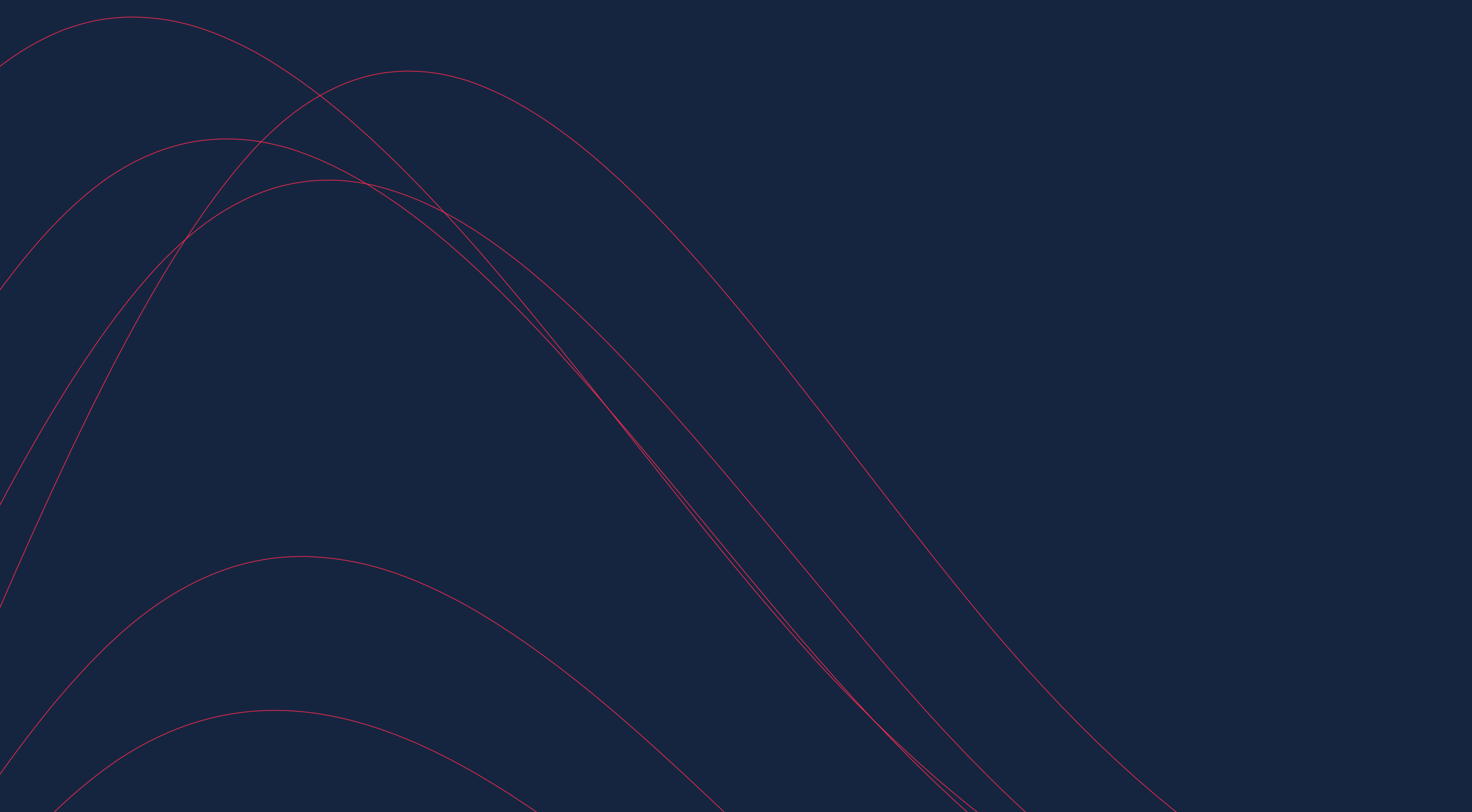
Fed proposes Regulation II changes on debit card transactions under the Durbin Amendment

The Federal Reserve (Fed) on 7 May 2021 announced a notice of proposed rulemaking that would amend Regulation II to clarify that debit card issuers are required to allow merchants a choice for routing card-not-present debit payments. The proposal will make clear that the requirement that each debit card transaction must be able to be processed on at least two unaffiliated payment card networks applies to card-not-present transactions. It would also clarify the requirements imposed on debit card issuers to ensure that at least two unaffiliated payment card networks have been enabled for debit card transactions.

A Fed staff memo to the Board of Governors notes that, "In the decade since the adoption of Regulation II, spurred by the growth in online commerce, card- not-present transactions have become an increasingly significant portion of all debit card transactions, and technology has evolved to enable multiple networks for these transactions. Despite this, two unaffiliated payment card networks are often not available to process card-not-present transactions, such as online purchases, because some issuers do not enable multiple networks for such transactions." Fed staff further note that card-not-present transactions have become even more prevalent since the COVID-19 pandemic as consumers have shifted from in-person to remote purchases.

In conjunction with the proposed rule, the Fed also published a biennial report containing summary information on debit card transactions in 2019, including information on volume and value, interchange fee revenue, certain issuer costs and fraud losses. Payment card networks in the US processed USD79.2 billion debit and general-use prepaid card transactions valued at USD3.1 trillion in 2019, according to the report. Total transaction volume grew by 7%, largely consistent with the growth pattern recorded since 2009. The report is the sixth in a series published every two years as prescribed by the Electronic Fund Transfer Act (EFTA).

The Fed promulgated its Regulation II network exclusivity and routing restrictions in 2011, pursuant to EFTA amendments under the so-called Durbin Amendment in the Dodd-Frank Act.

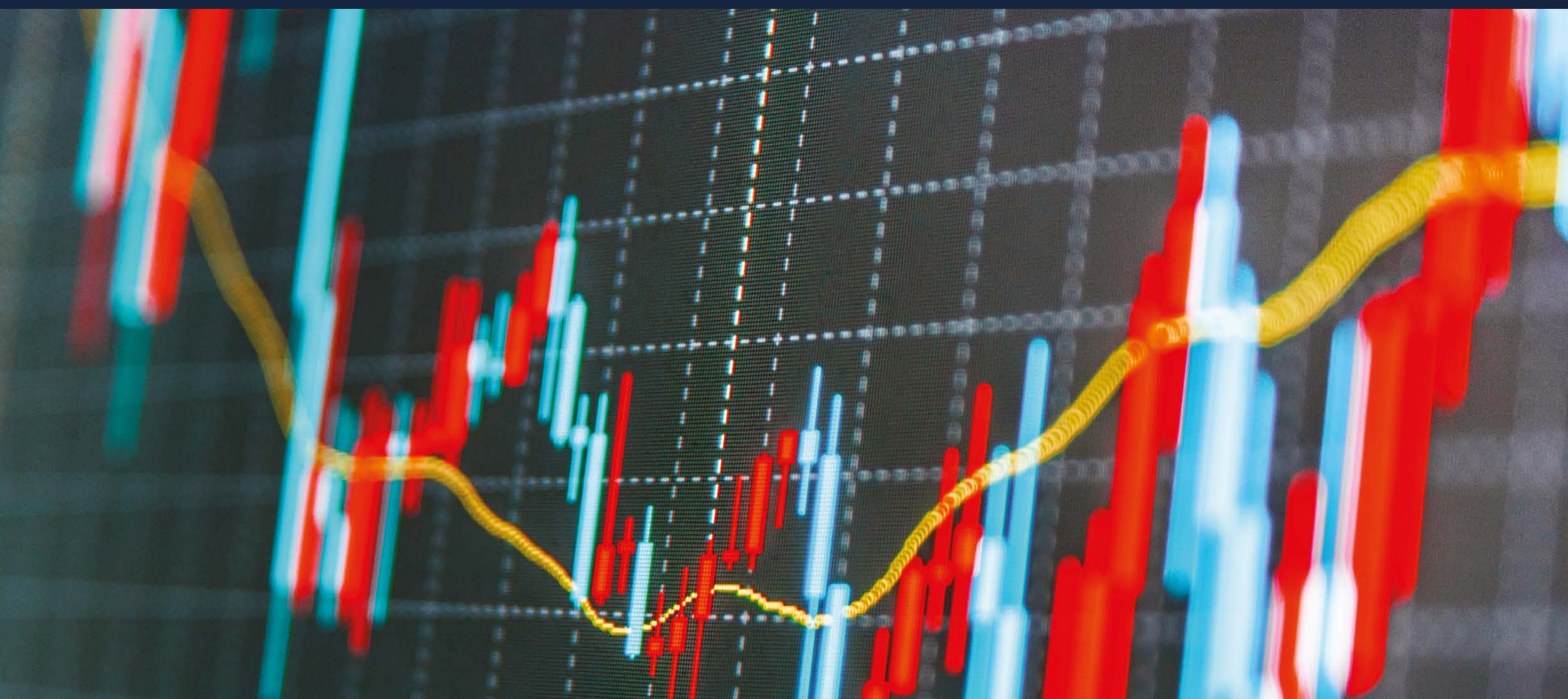


Fed Board announces final rule to reduce risk through application of netting protections to a broader range of financial institutions

On 18 February 2021, the Federal Reserve Board issued "a final rule that is intended to reduce risk and increase efficiency in the financial system by applying netting protections to a broader range of financial institutions." The amendments to the Fed's Regulation EE (Financial Institution Netting) were adopted under the Federal Deposit Insurance Corporate Improvement Act of 1991 (FDICIA) and apply to the operation of certain netting agreements. Parties to a netting agreement agree to pay and receive net payments, rather than gross amounts due, under the netting contract. FDICIA's provisions create market certainty – and provide related regulatory capital benefits – that these netting contracts will be enforced, "even in the event of the insolvency of one of the parties." The Fed's amendments to Regulation EE bring new entities, including swap dealers, into the scope of financial institutions that are parties to netting agreements and covered by FDICIA's protections. The Board noted in its release that the amendments were adopted with an aim toward consistency with "FDICIA's goals of reducing systemic risk and increasing efficiency in the financial markets" and "expands the definition of financial institution to ensure that certain entities qualify as financial institutions," such as:

- swap dealers and security-based swap dealers
- major swap participants and major security-based swap participants
- nonbank systemically important financial institutions
- certain financial market utilities
- foreign banks
- bridge institutions
- qualifying central counterparties
- The Bank for International Settlements
- foreign central banks
- Federal Reserve Banks

The final rule became effective on 29 March 2021.



International

FSB letter to G20 finance ministers and Central Bank governors

- On 24 February 2021, Randal K. Quarles, the Chair of the Financial Stability Board (FSB), wrote an open letter to Finance Ministers and Central Bank Governors on the FSB's key priorities for 2021 ahead of their virtual meeting on 26 February 2021.
- The Chair noted the unprecedented challenges faced by the FSB, like many others, due to the outbreak of COVID-19 and the imposition of containment measures across the globe (the COVID-19 event). Notwithstanding this, the FSB 2021 work programme is to proceed, including with its priorities which include addressing vulnerabilities directly related to COVID-19 and the resilience of non-bank financial intermediation (NBFI).
- In the letter, the Chair sets out a range of FSB deliverables and associated dates for this year.

Addressing COVID-19 related vulnerabilities

The FSB has supported international coordination on policy responses to COVID-19. The FSB is now considering factors needed to prepare for an orderly unwinding of COVID-19 support measures, where such unwinding is appropriate. The FSB is also developing a better understanding of the risks to financial stability of rising debt levels in the corporate sector. The Chair proposes to report on this work to the G20 in April.

The FSB will also provide the G20 an assessment of initial lessons learnt from the COVID-19 event for financial stability, with an interim report in July and a final report in October. This assessment will, alongside the work of other standard setting bodies (SSBs), examine how well capital and liquidity buffers as well as crisis management and operational resilience arrangements worked during the COVID-19 event.

Increasing the resilience of NBFI

The FSB work programme aims to strengthen the resilience of NBFI.

The need for such strengthening was seen in the market turmoil of March 2020 where investors mistakenly understood money market funds (MMFs), particularly non-government MMFs, to be cash equivalent resulting in liquidity mismatches. The Chair announced that the FSB, with SSBs, will provide a consultative report to the G20 in July on policy proposals to enhance MMF resilience, and a final report in October.

In addition, the FSB will continue to examine:

- margin calls in centrally cleared and uncleared markets;
- liquidity preparations of market participants for margin calls;
- open-ended fund types that faced redemption challenges in the 2020 market turmoil; and
- structural and interconnectedness issues in NBFI, including the interaction of USD funding pressures and fund outflows in emerging market economies.

Making cross-border payments cheaper, faster and more inclusive

G20 Leaders have endorsed the FSB's Roadmap to enhance cross-border payments. In the letter, the Chair states that the next step is setting quantitative targets. The FSB will deliver a final set of targets in October for G20 enforcement, together with an overall progress report on the implementation of the FSB Roadmap.

The FSB is continuing its work on global stablecoins as part of the Roadmap. Last October, the FSB submitted to the G20 high-level recommendations to address the regulatory, supervisory and oversight challenges raised by global stablecoins. In the letter, the Chair states that the FSB will update the G20 in October on how national and international frameworks capture stablecoins in light of the FSB recommendations.

Bettering our understanding of climate-related risks

In addition to assessing the availability of data through which climate-related risks to financial stability can be monitored, the FSB will also explore ways of promoting globally comparable, high quality and auditable standards of disclosure based on the recommendations of the Task Force on Climate-related Financial Disclosure. The FSB continues to review regulatory approaches to addressing climate-related risks at financial institutions.

Addressing other financial stability topics of ongoing importance

The Chair notes that the COVID-19 event cannot result in the FSB pausing its work on addressing other important financial stability topics. These include the smooth transition away from LIBOR, enhancing central counterparty resilience and revising the FSB Cyber Lexicon.

Road ahead

The Chair concludes the letter by noting that the COVID-19 event may yet require adjustments to the FSB Work Programme and additional analysis for topics yet to be foreseen.

That being said, the Chair particularly looks forward to delivering final reports on policy proposals to enhance MMF resilience and lessons learnt from COVID-19.

Contact us

For further information, please contact:

AUSTRALIA

Samantha O'Brien
Partner
+61 7 3246 4122
samantha.obrien@dlapiper.com

Martin Jamieson
Partner
+612 9286 8059
martin.jamieson@dlapiper.com

AUSTRIA

Jasna Zwitter-Tehovnik
Partner
+43 1 531 78 1025
jasna.zwitter-tehovnik@dlapiper.com

BELGIUM

Pierre Berger
Partner
+32 (0) 3 287 2828
pierre.berger@dlapiper.com

Johan Mouraux
Partner
+32 (0)2 500 1673
johan.mouraux@dlapiper.com

CHINA – HONG KONG

Harris Chan
Partner
+852 2103 0763
harris.chan@dlapiper.com

Paul Lee
Partner
+852 2103 0886
paul.lee@dlapiper.com

CZECH REPUBLIC

Miroslav Dubovský
Country Managing Partner
+420 222 817 500
miroslav.dubovsky@dlapiper.com

DENMARK

Martin Christian Kruhl
Partner
+45 33 34 08 42
martin.kruhl@dlapiper.com

FRANCE

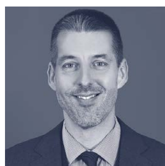
Sébastien Praicheux
Partner
+331 70 75 76 91
sebastien.praicheux@dlapiper.com

GERMANY

Dr. Gunne W. Bähr
Partner
+49 221 277 277 283
gunne.baehr@dlapiper.com

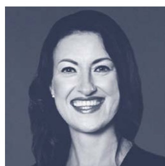
Dennis Kunschke
Partner
+49 69 271 33 191
dennis.kunschke@dlapiper.com

HUNGARY



András Nemescsói
Partner
+36 1 510 1180
andras.nemescsoi@dlapiper.com

IRELAND



Eimear O'Brien
Legal Director
+353 1 487 6676
eimear.obrien@dlapiper.com

ITALY

Agostino Papa
Partner
+39 06 68 880 513
agostino.papa@dlapiper.com

Vincenzo La Malfa
Partner
+39 06 68 88 01
vincenzo.lamalfa@dlapiper.com

LUXEMBOURG

Catherine Pogorzelski
Partner
+352 26 29 04 20 53
catherine.pogorzelski@dlapiper.com

Laurent Massinon
Partner
+352 26 29 04 2021
laurent.massinon@dlapiper.com

Xavier Guzman
Partner
+352 26 29 04 2052
xavier.guzman@dlapiper.com

MIDDLE EAST

Paul McViety
Partner, Head of Islamic Finance
+971 4 438 6260
paul.mcviety@dlapiper.com

Paul Latto
Partner
+966 11 201 8900
paul.latto@dlapiper.com

MOROCCO

Fabrice Armand
Partner
+33 1 40 15 24 43
fabrice.armand@dlapiper.com

NETHERLANDS

Paul Hopman
Partner
+31 20 541 9952
paul.hopman@dlapiper.com

NORWAY

Camilla Wollan
Partner
+47 2413 1659
camilla.wollan@dlapiper.com

PORTUGAL

João Costa Quinta
Partner
+351 21 358 36 20
joao.quinta@dlapiper.com

ROMANIA

Andreea Badea
Managing Associate
+40 372 155 827
andreea.badea@dlapiper.com

SLOVAKIA

Eva Skottke
Legal Director
+421 2 592 021 11
eva.skottke@dlapiper.com

SPAIN

Ricardo Plasencia
Partner
+34 91 790 1708
ricardo.plasencia@dlapiper.com

SWEDEN

Alf-Peter Svensson
Partner
+46 8 701 78 00
alf-peter.svensson@dlapiper.com

UK

Michael McKee
Partner
+44 20 7153 7468
michael.mckee@dlapiper.com

Tony Katz
Partner
+44 20 7153 7835
tony.katz@dlapiper.com

Sam Millar
Partner
+44 20 7153 7714
sam.millar@dlapiper.com

Sophie Lessar
Partner
+44 20 7796 6187
sophie.lessar@dlapiper.com

US

Sidney Burke
Partner
+1 212 335 4509
sidney.burke@dlapiper.com

Christopher Steelman
Partner
+1 202 799 4366
christopher.steelman@dlapiper.com

John Reiss
Partner
+1 212 335 4680
john.reiss@dlapiper.com

Deborah Meshulam
Partner
+1 202 799 4511
deborah.meshulam@dlapiper.com

Jeffrey Hare
Partner
+1 202 799 4375
jeffrey.hare@dlapiper.com

Isabelle Ord
Partner
+1 415 836 2536
isabelle.ord@dlapiper.com

Bradley Phipps
Associate
+1 215 656 2472
bradley.phipps@dlapiper.com

Mary Dunbar
Partner
+1 202 799 4255
mary.dunbar@dlapiper.com

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