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PRIVATE BANK BRIEFING

LATHAM & WATKINS

Issues Impacting the Private Bank Sector

Welcome to our quarterly round-up of legal and compliance issues impacting private banks and their clients.

In This Edition

Brexit: Latest Updates

Private banks are currently going through a process of assessing the changes that need to be made to their systems and controls, in addition to client facing documentation, to facilitate the onshoring of EU financial services regulations into UK law (for example MiFID II, EMIR, BMR, UCITS, AIFMD, and MAR) by the end of the Brexit transition period (and assuming the UK exits the EU without a deal on 1 January 2021).

Private banks will, therefore, need to ensure that they have reviewed whether the temporary transitional relief applies to each of the onshoring changes relevant to them in order to determine the "Day 1" requirements they will need to comply with from the end of the transition period (i.e., from 1 January 2021).

On 25 March 2020, the Economic Secretary to the Treasury published a written ministerial statement that highlighted the importance of regulators having the flexibility to smooth any adjustments to the UK's regulatory regime for financial services at the end of the Brexit transition period on 31 December 2020. In order to facilitate the transition, the government confirmed that HM Treasury will retain the regulators' Temporary Transitional Power (TTP). The shift in the TTP's application means it will be available for use by UK financial services regulators for a period of two years from the end of the transition period.

The TTP will allow the UK regulators to phase in changes to UK law arising from the end of the transition period, ensuring firms will have time to adjust to the UK's post-transition regime in an orderly way.

The Bank of England, the PRA, and the FCA have confirmed that they intend to grant such relief for a period of 15 months after the end of the transition period, until 31 March 2022. However, the relief will not apply on a blanket basis. Whilst the regulators have defined certain key areas where the relief will not apply, this list is not exhaustive. Private banks will, therefore, need to ensure that they have reviewed whether the temporary transitional relief applies to each of the onshoring changes relevant to them in order to determine the "Day 1" requirements they will need to comply with from the end of the transition period (*i.e.*, from 1 January 2021).

As the UK moves closer to the end of the Brexit transition period, Private Banks should also ensure that they are factoring on-going developments into their Brexit planning scenarios. In a speech delivered on 6 May 2020, Nausicaa Delfas, Executive Director of International at the FCA, highlighted that certain Brexit issues cannot be resolved through equivalence, including broader contract continuity issues, and the continued provision of retail financial services by UK firms to EU consumers. Whilst the FCA has put transitional regimes in place for EEA firms, the situation for UK firms in the EU is not the same.

Their continued operations after the end of the transition period will depend on the regulatory regimes of individual EU member states. Though many of these member states had put in place temporary transitional regimes in the event of a "no-deal" exit, the majority of these have now lapsed. Accordingly, Private Banks looking to rely on transitional regimes should ensure that they have checked the current status and availability of these regimes, and updated their Brexit planning accordingly.

Brexit: UK Approach to Implementing Regulatory Reforms Post Brexit

On 23 June 2020, the House of Commons published a written statement from Rishi Sunak, Chancellor of the Exchequer, on the UK's approach to implementing financial services regulatory reforms before the end of the Brexit transition period, to ensure relevant regulations remain appropriate for the UK financial sector.

The statement outlines several areas relevant to private banks where the UK is looking to amend the implementation of EU financial regulation.

SFTR

The UK will not be incorporating into UK law the reporting obligation of the Securities Financing Transactions Regulation (SFTR) for non financial counterparties (NFCs), which is due to apply in the EU from January 2021. Given that systemically important NFC trading activity will be captured sufficiently through the other reporting obligations that are due to apply to financial counterparties, it is appropriate for the UK not to impose this further obligation on UK firms.

The FCA has updated its SFTR webpage to reflect this change.

BMR

HM Treasury plans to make amendments to the Benchmarks Regulation (BMR) to ensure continued market access to third country benchmarks until the end of 2025. HM Treasury will publish more information in July 2020.

MAR

HM Treasury intends to make amendments relating to the Market Abuse Regulation (MAR) to confirm and clarify that both issuers, and those acting on their behalf, must maintain their own insider lists, and to change the timeline issuers have to comply with when disclosing certain transactions undertaken by their senior managers ("Persons Discharging Managerial Responsibilities").

PRIIPs

HM Treasury plans to publish legislation to improve the functioning of the UK's packaged retail and insurance based investment products (PRIIPs) regime and address potential risks of consumer harm. HM Treasury will publish more information in July 2020.

FCA: Priorities for 2020-2021

On 7 April 2020, the FCA published its 2020/21 Business Plan outlining key priorities over the next one to three years. The FCA has stated that whilst its immediate focus is to address the challenges presented by COVID-19, it has identified five key areas it will be working on:

Transforming how the FCA works and regulates. The FCA has ambitious plans to fundamentally change the way it works by considering how to prioritise and deliver outcomes, how to use data and technologies, and what capabilities are needed for it to be fit for the future. The FCA acknowledges that it must make faster and more effective decisions and its day-to-day regulation must adapt as the regulatory context becomes more complex and the number of firms it regulates increases, including broadening its approach in choosing regulatory tools. The regulator also aims to review how it identifies, prioritises, and acts on information and intelligence it receives about the markets, firms, and individuals it regulates. This includes the implementation of a new data strategy. Additionally, the FCA wants to build stronger links with its global partners in preparation for EU-withdrawal.

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Enabling effective consumer investment decisions. The FCA sees a significant risk of harm in the pensions and retail investments markets; this has been further exacerbated by the market volatility brought about by COVID-19. The regulator wants to ensure that consumers are not exposed to more investment risk than they expected or can absorb. Additionally, the FCA wants to ensure that consumers have access to the high-quality advice and support they need to protect themselves from scams and fraud, supported by its new consumer harm campaign. The regulator also seeks to make sure that firms have higher standards of governance that will allow the regulatory system to better tackle the significant cost of misconduct in the market.

Ensuring consumer credit markets work well. The FCA wants consumers to have access to clear and simple information that allows them to understand the range and features of available products. The FCA acknowledges that consumers may be getting unaffordable credit, and that firms may be benefiting from exploitive fees and charges. The regulator wants to prevent consumers from being extended credit they cannot be reasonably expected to pay whilst ensuring that there is increased access to fair and affordable credit.

The FCA expects firms to safeguard customer funds, and will act swiftly when firms fail to meet their safeguarding requirements.

Making payments safe and accessible. The FCA aims to increase its focus on evaluating firms' systems and controls regarding data storage to minimise the risk of fraud and operational outages. The FCA expects firms to safeguard customer funds, and will act swiftly when firms fail to meet their safeguarding requirements. It acknowledges that as firms' business models change, they may stop providing some services to some consumer groups. The FCA intends to make sure that these consumer groups continue to have access to cash.

Delivering fair value in a digital age. The FCA wants consumers to benefit from digital innovation and competition. To that end, it wants consumers to be able to assess, access, and act on available information as markets become increasingly digital. The FCA expects firms to use data and algorithms ethically to price and to have adequate controls to prevent undue bias or discrimination. In addition, the FCA wants to ensure that vulnerable customers are not exploited and has published guidance on the fair treatment of these customers.

The FCA also sets out its six cross-cutting work priorities (which include Brexit, climate change, and operational resilience) and its planned sector work in wholesale financial markets, investment management, retail banking, and general insurance and protection.

SMCR: Directory of Certified and Assessed Persons — Publication Delayed

Pursuant to the SMCR, the FCA was due to commence publishing a directory of certified and assessed persons on the Financial Services Register at the end of March 2020.

The FCA has released a statement saying that publication of the directory has been delayed and timing of the launch is now under review due to the COVID-19 outbreak, and that the FCA will provide further updates on timing.

By way of reminder, the deadlines for submitting certified and assessed persons information are:

- 9 December 2020 for solo-regulated firms
- 9 March 2020 for banks, building societies, credit unions, and insurance companies

The FCA has released a statement saying that publication of the directory has been delayed and timing of the launch is now under review due to the COVID-19 outbreak.

The FCA has stated that dual-regulated firms can either regularly update their certified and assessed persons data as changes occur prior to launch, or can wait and provide a bulk update once the new launch date is confirmed by the FCA.

COVID-19: FCA Expectations on Financial Crime Systems and Controls

On 6 May 2020, the FCA published a statement outlining its expectations on how firms should apply their systems and controls to combat and prevent financial crime during the COVID-19 crisis. The FCA has warned that criminals are already taking advantage of the crisis to carry out fraud and exploitation scams, including cyber-enabled fraud.

Whilst the FCA has recognised that the current climate may give rise to operational challenges for financial crime systems and controls, private banks should not seek to address operational issues by changing their risk appetite. However, the FCA will consider reasonable certain delays in some activities, if on a risk basis (for example, reviews for high-risk customers should not be delayed unless absolutely necessary), and as long as there is a clear plan to return to the business-as-usual review process as soon as reasonably practicable.

The FCA expects firms to continue to comply with their client identity verification obligations and private banks should be reminded of the flexibility within the existing requirements for this to be carried out remotely, by using a combination of the following (when appropriate):

- Accept scanned documentation sent by e-mail, preferably as a PDF
- Seek third-party verification of identity to corroborate that provided by the client, *e.g.*, from their lawyer or accountant
- Ask clients to submit digital photos or videos for comparison with other forms of identification gathered as part of the on-boarding process
- Place reliance on due diligence carried out by others, such as the client's primary bank account provider, where appropriate agreements are in place to provide access to data
- Use commercial providers who triangulate data sources to verify documentation provided
- Use digital identity solutions to identify customers if a firm considers that the solution provides an appropriate level of assurance of a person's identity
- Gather and analyse additional data to triangulate the evidence provided by the client, such as geolocation, IP addresses, verifiable phone numbers
- Verify phone numbers, emails and/or physical addresses by sending codes to the client's address to validate access to accounts
- Seek additional verification once restrictions on movement are lifted for the relevant client group

Whilst the FCA has recognised that the current climate may give rise to operational challenges for financial crime systems and controls, private banks should not seek to address operational issues by changing their risk appetite.

These examples do not, however, represent a relaxation of requirements, or suggest that taking one of the measures in isolation would be appropriate or sufficient for verification. Any steps firms take to verify identity must be in line with their overall risk assessment and the risk profile of the customer.

At the end of the statement, the FCA reminds firms that senior managers performing required functions, including the MLRO, should only be furloughed as a last resort.

COVID-19: FCA Expectations on Information Security

The FCA has acknowledged that criminals are increasingly exploiting COVID-19 for their own gain and that operational disruptions (including cyber-related incidents) can mean important business services are unavailable. Such disruptions have the potential to cause wide-reaching harm to consumers and market integrity, threaten the viability of firms, and cause instability in the financial system.

While the FCA has conceded that business continuity may require alternative ways of working, it expects firms to prioritise information security, ensure adequate controls to manage cyber threats, and respond to major incidents.

As a result, the FCA expects firms to:

- Be vigilant to the potential increase in security breaches or cyber-attacks
- Maintain appropriate governance and oversight arrangements
- Review the impact of COVID-19 on their information and systems security defences and take action as needed
- Follow the general notification requirements and report significant operational/cyber incidents

While the FCA has conceded that business continuity may require alternative ways of working, it expects firms to prioritise information security, ensure adequate controls to manage cyber threats, and respond to major incidents.

The FCA explains that it is working closely with industry to ensure that workarounds and continuity actions do not adversely impact firms' information security controls and their ability to provide services to customers.

COVID-19: FCA Statement on Handling Complaints

On 1 May 2020 (subsequently updated on 7 May 2020), the FCA published a statement about how firms should handle complaints during the COVID-19 crisis.

The FCA states that handling complaints is an important function which should continue, despite the pandemic. Firms should take all reasonable steps to ensure as much complaint handling as possible continues through staff working from home, when this can be done fairly and effectively. The FCA understands that firms' capacity to handle complaints could be reduced during the pandemic and, therefore, expects firms to prioritise:

- Paying promptly complainants who have been offered redress and accepted that offer
- The prompt and fair resolution of complaints from:
  - Consumers who are likely to be vulnerable to harm if their complaint is not resolved promptly and fairly
  - Micro-enterprises and small businesses who are likely to face serious financial difficulties if their complaint is not resolved promptly and fairly
- Sending timely holding responses vulnerable complainants when their complaints cannot be resolved promptly

Notably, the FCA states that if a firm cannot deliver these three priorities adequately and effectively through home working, then the FCA considers it appropriate for the firm to maintain the minimal physical onsite presence needed to do so.

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Private banks should note in particular that while the FCA acknowledges that firms may be dealing with fewer complaints each week and therefore taking longer than usual to answer some complaints, the FCA does not expect any reduction in the quality of firms' complaint handling.

The FCA highlights that firms should be aware that COVID-19 and associated public health measures are likely to exacerbate the personal circumstances that can cause vulnerability. These measures may also cause many consumers who would not normally think of themselves as vulnerable to suddenly face personal circumstances that can cause vulnerability (*e.g.*, loss of income from losing employment or being furloughed, the impact of isolation on mental and physical health, people's ability to work and care for others, and, particularly in the case of some key workers, the impact of extremely demanding working conditions and greater exposure to the virus itself). The FCA emphasises that while its definition of vulnerable consumer was developed with individuals in mind, firms should be aware that micro-enterprises and small businesses can also face circumstances that make them especially susceptible to harm if a firm's failure to act with appropriate levels of care means their complaint is not resolved promptly and fairly.

Private banks should note in particular that while the FCA acknowledges that firms may be dealing with fewer complaints each week and therefore taking longer than usual to answer some complaints, the FCA does not expect any reduction in the quality of firms' complaint handling. In addition, the FCA states that any firm that experiences material difficulties in complying with DISP 1.6 (in particular the requirement to provide a final response to complaints within eight weeks of receipt, or within 15 days of receipt for payment services or e-money complaints) should inform their usual supervisory contact.

Complaints: FCA Publishes Complaints Data

On 16 April 2020, the FCA issued a press release announcing the publication of complaints data collected during the second half of 2019.

The data shows an increase in complaints from 4.29 million in the first half of 2019 to 6.02 million in the second half of 2019. This was mainly due to a 75% increase in the volume of complaints about PPI, which made up 62% of all complaints received during the reporting period and coincided with the 29 August 2019 deadline for customers to submit PPI claims.

Excluding PPI, the most complained-about products were current accounts (10% of all complaints), credit cards (6%), and other general insurance products (5%). Complaints about home finance products decreased from 8.7 to 8.4 complaints per 1,000 balances outstanding, while investment products increased from 2.1 to 2.3. Excluding PPI, the average redress per complaint upheld decreased from £200 in the first half of 2019 to £184 in the second half.

The FCA has also published new webpages on:

- Complaints data: This summarises the latest findings and explains the FCA's approach to the publication of complaints data.
- Aggregate complaints data: This contains information on the complaints that firms reported to the FCA, including the most complained-about products, the main reasons for complaints, and outcomes for consumers.
- Firm specific complaints data: This contains data from firms that report 500 or more complaints within the second half of 2019, or 1,000 or more for an annual reporting period.

These resources can be useful for firms seeking to benchmark their own complaints data against peers and to discover more granular detail on complaints on specific services or products.

Complaints: FOS Publishes its Future Strategy and Annual Complaints Data

Future Strategy

On 8 April 2020, the FOS published its future strategy, which will run until 2025.

Private banks may wish to note that the FOS is increasing its case fee paid by firms for the first time since 2013, from £550 to £650; however, the FOS is keeping the "free" case allowance at its current level of 25 for firms outside its group account fee arrangement. Seventy percent of its income will now come from case fees, against the 60% proposed in its consultation.

Annual Complaints Data

The FOS has published its annual complaints data for the year ending 31 March 2020, together with the publication, "Lessons from the past, ambitions for the future: our 2019/20 complaints data analysis". The publication contains commentary from the chief ombudsman on the annual data, together with sector-by-sector insight into trends in complaints.

The commentary from the chief ombudsman makes some interesting observations around some of the points the FOS will need to consider when it comes to assessing complaints arising out of the COVID-19 environment. She states that COVID-19 has already given rise to many new and complex questions of fairness, the answers to which are not straightforward but that the FOS has the tools and experience to find them. Private banks should review their COVID-19 response framework to ensure that it focuses on customer fairness, while also examining any FOS decisions on this topic for read-across to their own businesses.

Private banks may wish to note that the FOS is increasing its case fee paid by firms for the first time since 2013, from £550 to £650; however, the FOS is keeping the "free" case allowance at its current level of 25 for firms outside its group account fee arrangement.

Sustainable Finance: SFDR

The EU's Sustainable Finance Action Plan seeks to clarify the duties of financial institutions in helping to shift capital flows away from activities that have negative social and environmental consequences and direct finance towards economic activities that have genuine long-term benefits for society. It will achieve this by implementing new regulation impacting EU financial institutions, specifically the Taxonomy Regulation and the Sustainable Finance Disclosure Regulation (SFDR); as well as amendments to existing regulations: MiFID II; AIFMD, UCITS Directive, Solvency II, and the Insurance Distribution Directive (IDD). The EU Commission is consulting on a series of delegated acts (the Delegated Acts) to enable these amendments and to facilitate the implementation of the SFDR.

For private banks in particular, the SFDR introduces a number of new obligations in relation to their systems and controls, conflicts, remuneration of staff, asset management, and advisory services.

The SFDR captures a range of entities across the financial services sector. For private banks in particular, the SFDR introduces a number of new obligations in relation to their systems and controls, conflicts, remuneration of staff, asset management, and advisory services. Specifically, firms must make transparent their sustainability targets and demonstrate how their activities and investments correlate to those targets by complying with the following obligations:

- **Governance:** Publish on a website details of how sustainability risks are integrated into the organisational, risk management, and governance process
- **Policies:** Publish and keep up-to-date written policies on the integration of sustainability risks — both principal adverse impacts and all relevant sustainability risks — that might have a relevant material negative impact on the financial return of an investment or advice
- **Remuneration:** Remuneration policies must reflect how they are consistent with the integration of sustainability risks, and such information must be disclosed on firms' websites
- **Due diligence disclosures:** Publish on websites due diligence policies with regard to principal adverse impacts of investment decisions on sustainability factors (or clear reasons why such sustainability adverse impacts are not considered), including adherence with business codes and internationally recognised standards
- **Product disclosures:** For financial products that have ESG factors as their objective, publish and maintain information on the methodologies used to assess, measure, and monitor the ESG impact (*e.g.*, benchmark indices)
- **Pre-contractual disclosures:** These disclosures should cover the manner in which sustainability risks and ESG objectives are integrated into investment decisions/advice and the likely impacts of sustainability risks on the returns of financial products
- **Marketing communications:** Any marketing communications must not contradict information disclosed to investors elsewhere on sustainability risks
- **Periodic reporting:** For financial products that promote ESG characteristics, periodic reports should disclose the extent to which those characteristics are met

Private banks must prepare for the phased implementation of the SFDR as follows:

- **10 March 2021:** The majority of provisions take effect
- **30 June 2021:** Firms to publish on websites due diligence policies with regard to principal adverse impacts of investment decisions on sustainability factors (or clear reasons why such are not considered)

- **1 January 2022:** Certain requirements in relation to periodic reporting take effect (for the calendar year before)
- **30 December 2022:** Firms to disclose adverse sustainability impacts at financial product level

Delegated Acts

On 8 June 2020, the EU Commission launched various consultations on the Delegated Acts across a range of existing EU financial services regulations.

The proposals in the Delegated Acts most relevant to private banks are set out below:

MiFID investment firms	
Organisational requirements and risk management	Investment firms must take into account sustainability risks when complying with the MiFID II organisational requirements and to integrate *sustainability risk* into the risk management policies and procedures which identify the risks relating to the firm's activities, processes, and systems. This includes setting the level of risk tolerated by the firm taking into account *sustainability risks*.
Conflicts of interest	When assessing whether a conflict of interest may damage the interest of a client, such assessment must include the client's *sustainability preferences*. This could include those types of conflicts of interest that stem from the distribution of *sustainable investments* or from investments that *promote environmental or social characteristics*, in addition to conflicts associated with remuneration of staff.
Information about investment advice	When disclosing the factors taken into consideration in the selection process used to recommend financial instruments, including the risks, costs, and complexity of the financial instruments, firms must also include any *sustainability factors*.
Assessment of suitability and suitability reports	Investment firms providing financial advice and portfolio management should carry out a mandatory assessment of their clients' *sustainability preferences*. These investment firms should take clients' sustainability preferences into account in the selection process of the financial products that firms offer to clients. Adequate policies and procedures must ensure that firms understand the nature, features, including costs, risks of investment services, and financial instruments selected for their clients, including any sustainability factors, and firms shall assess, while taking into account cost and complexity, whether equivalent investment services or financial instruments can meet their client's profile (including sustainability preferences). Suitability reports must explain how the recommendation meets the client's sustainability preferences.
Product governance: Manufacturers	**Target market:** Firms must consider sustainability preferences when specifying the type(s) of client for whose needs, characteristics, and objectives the financial instrument is compatible with. **Review:** Firms must consider if the financial instrument remains consistent with any sustainability preferences of the target market and if the financial instrument reaches clients for whose preferences it is not compatible.
Product governance: Distributors	**Target market:** Firms must have in place adequate product governance arrangements to ensure that products and services firms intend to offer or recommend are compatible with the sustainability preferences of an identified target market. **Review:** Firms must assess whether the product or service remains consistent with the sustainability preferences of the identified target market.

AIFMs	
Due diligence requirements	Consideration of *sustainability risks* in due diligence requirements are now included.
Necessary resources and expertise	AIFMs must retain the necessary resources and expertise to effectively integrate *sustainability risks*.
Conflicts of interest	When identifying the types of conflicts of interest, the existence of which may damage the interests of an AIF, AIFMs must include those types of conflicts of interest that may arise as a result of the integration of *sustainability risks* in their processes, systems, and internal controls. Those conflicts may include conflicts arising from remuneration or personal transactions of relevant staff, conflicts of interest that could give rise to greenwashing, mis-selling or misrepresentation of investment strategies, and conflicts of interests between different AIFs managed by the same AIFM.
Risk management policy	The risk management policy shall comprise such procedures as are necessary to enable the AIFM to assess for each AIF it manages the exposure of that AIF to market, liquidity, *sustainability and counterparty risks*, and the exposure of the AIF to all other relevant risks, including operational risks, which may be material for each AIF the AIFM manages.

AIFMs *cont...*	
General organisational requirements	AIFMs are obligated to manage and to ensure sustainability risks are embedded within: a. Decision-making procedures and organisational structures which specify reporting lines and allocates functions and responsibilities clearly and in a documented manner b. Ensuring that the relevant persons are aware of the procedures to be followed for the proper discharge of their responsibilities c. Internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the AIFM d. Effective internal reporting and communication of information at all relevant levels of the AIFM and effective information flows with any third party involved e. Adequate and orderly records of their business and internal organisation
Control by the governing body, senior management, and supervisory function	Senior management of the AIFM is responsible for the integration of sustainability risks in relation to: a. Each AIFs investment policy and where relevant, in the fund rules, the instruments of incorporation, the prospectus, or the offering documents b. The approval of the investment strategies for each managed AIF c. The valuation policies and procedures d. The compliance function e. Effective implementation of and compliance with the general investment policy, the investment strategies, and the risk limits of each managed AIF f. The adequacy of the internal procedures for undertaking investment decisions for each managed AIF, so as to ensure that such decisions are consistent with the approved investment strategies g. The risk management policy and the arrangements, processes, and techniques for implementing that policy, including the risk limit system for each AIF it manages h. The remuneration policy

UCITS management companies	
General requirements on procedures and organisation	Management companies must take into account sustainability risks in the context of: a. Decision-making procedures and an organisational structure which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities b. Ensuring that the relevant persons are aware of the procedures that must be followed for the proper discharge of their responsibilities c. Adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the management company d. Effective internal reporting and communication of information at all relevant levels of the management company as well as effective information flows with any third party involved e. Maintainance of adequate and orderly records
Necessary resources and expertise	Management companies to retain the necessary resources and expertise for the effective integration of *sustainability risks*.
Investment company integration of sustainability risks	Investment companies must integrate *sustainability risks* in the management of UCITS.
Senior management responsibility	Senior management of the management company is responsible for the integration of *sustainability risks.*
Conflicts of interest	Management companies should, when identifying the types of conflicts of interest that may damage the interests of a UCITS, include conflicts of interest that may arise as a result of the integration of *sustainability risks* in their processes, systems, and internal controls. Those conflicts may include conflicts arising from remuneration or personal transactions of relevant staff, conflicts of interest that could give rise to greenwashing, mis-selling or misrepresentation of investment strategies, and conflicts of interests between different UCITS managed by the same management company.
Due diligence requirements	Due diligence procedures should take into account sustainability risks. Where management companies, or, where applicable, investment companies, consider principal adverse impacts of investment decisions on sustainability factors, due diligence requirements must also take due account of those adverse impacts.
General organisational requirements	The risk management policy shall comprise such procedures as are necessary to enable the management company to assess, for each UCITS it manages, the exposure of that UCITS to market, liquidity, sustainability, and counterparty risks, and the exposure of the UCITS to all other risks, including operational risks, which may be material for each UCITS it manages.

Draft RTS on ESG Disclosures

On 23 April 2020, the three European Supervisory Authorities (EBA, EIOPA, and ESMA – ESAs) issued a joint consultation paper seeking input on proposed RTS on ESG disclosures for financial market participants, advisers, and products resulting from the requirements in the SFDR.

The draft RTS relate to the content, methodology, and presentation of ESG disclosures both at entity-level and product-level. In addition, the consultation paper contains proposals under the Taxonomy Regulation, on the “do not significantly harm” principle.

The draft RTS relate to several disclosure obligations under the SFDR regarding the publication of:

- The details of the presentation and content of the information in relation to the **principle of “do not significantly harm”** as set out in Article 2(17) of the SFDR consistent with the content, methodologies, and presentation of indicators in relation to adverse impacts referred to in Article 4(6) and (7) of the SFDR
- A statement on an entity’s website of a statement on the due diligence policy in respect of the adverse impact of investment decisions on sustainability factors in relation to **climate and other environment-related impacts** (Article 4(6) of the SFDR) and **adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters** (Article 4(7) of the SFDR)
- **Pre-contractual information** on how a product with **environmental or social characteristics** meet those characteristics and if an index has been designated as a reference benchmark, whether and how that index is consistent with those characteristics (Article 8 of the SFDR)
- **Pre-contractual information to show**, where a product has **sustainable investment objectives** and a) has a designated index as a reference benchmark, how that index is aligned with the sustainable investment objective and an explanation as to why and how that designated index aligned with the objective differs from a broad market index (Article 9(1) of the SFDR); and b) if no index has been designated as a reference benchmark, an explanation on how that objective is to be attained (Article 9(2) of the SFDR)
- Information on an entity’s **website** to describe the environmental or social characteristics of financial products or the sustainable investment; the methodologies used; the pre-contractual information referred to in Articles 8 and 9 of the SFDR; and the periodic reports referred to in Article 11 of the SFDR
- Information in **periodic reports** according to sectoral legislation specifying (a) the extent to which products with environmental and/or social characteristics meet those characteristics; and (b) for products with sustainable investment objectives and products for which the objective is a reduction in carbon emissions: (i) the overall sustainability-related impact of the product by means of relevant sustainability indicators; and (ii) where an index has been designated as a reference benchmark, a comparison between the overall impact of the financial product with the designated index and a broad market index through sustainability indicators (Article 11 of the SFDR)

The draft RTS relate to the content, methodology, and presentation of ESG disclosures both at entity-level and product-level. In addition, the consultation paper contains proposals under the Taxonomy Regulation, on the “do not significantly harm” principle.

The deadline for responses to the consultation is 1 September 2020. Following the close of the consultation, the draft RTS will be finalised and submitted to the European Commission. The timing is quite tight as six of the RTS must be delivered by 30 December 2020, leaving only three months before the majority of the provisions under the SFDR will apply on 10 March 2021.

The remaining RTS, in respect of sustainability indicators in relation to adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters must be delivered by 30 December 2021.

Sustainable Finance: Draft Delegated Regulations on ESG Disclosures in Benchmarks

On 8 April 2020, the European Commission published the three draft delegated regulations required by the Low Carbon Benchmarks Regulation, setting out sustainability criteria for a benchmark to qualify as an EU Climate Transition Benchmark (EU CTB) or EU Paris-aligned Benchmark (EU PAB). The draft delegated regulations also set out the ESG disclosure requirements for benchmarks provided in accordance with the European Benchmarks Regulation. (See European Commission Publishes Draft Delegated Regulations on ESG Disclosures in Benchmarks.)

All benchmark administrators are required to explain clearly how ESG criteria are reflected for each benchmark or family of benchmarks from 30 April 2020. However, as the consultation period for the draft delegated regulations did not close until 6 May 2020, ESMA issued a no-action statement directing National Competent Authorities not to take any supervisory or enforcement action against firms not compliant with these new requirements by the original implementation deadline.

Where private banks use ESG benchmarks in financial instruments or funds, they should ensure that their policies are amended to reflect these new category of “ESG benchmarks” and embed due diligence processes to ensure that such benchmarks remain aligned with the private bank's own investment strategy around sustainable finance.

Market Abuse: FCA Updates Webpages on Reporting Suspected Market Abuse

Firms and individuals professionally arranging or executing transactions in certain financial instruments, and operators of a trading venue, must report suspicious transactions and orders (STORs) to the FCA without delay.

The FCA's webpage on reporting suspected market abuse now contains a new section on submitting a market observation. The FCA asks firms and trading venues to notify the FCA of activity they have observed in the market that is not required as a STOR (for example, where the firm or trading venue is not involved in the activity and therefore does not have complete information). In such cases, the FCA requests firms to submit a market observation.

The FCA's webpage on reporting suspected market abuse now contains a new section on submitting a market observation.

To submit a market observation, private banks should log in to Connect and complete the market observation form under "Notifications".

The FCA has also published a new webpage on how individuals can report suspected market abuse.

AIFMD: European Commission Report Assesses AIFMD Application and Scope

On 10 June 2020, the European Commission published a report assessing the application and scope of the Alternative Investment Fund Managers Directive (AIFMD). The report was prepared pursuant to Article 69 of the AIFMD and follows an earlier report prepared by KPMG in January 2019. (See European Commission Report on the Operation of the AIFMD.)

According to the report, the efficacy of the EU AIFM passport has been impaired by national "gold-plating" as well as divergences in national marketing rules and varying interpretations of the AIFMD by national supervisors.

The report covers four main topics, which are summarised below:

Impact on alternative investment funds (AIFs) and alternative investment fund managers (AIFMs)

According to the report, the efficacy of the EU AIFM passport has been impaired by national "gold-plating" as well as divergences in national marketing rules and varying interpretations of the AIFMD by national supervisors.

The report also highlights the fact that the AIFM passport allows marketing only to professional investors, and not, for example, retail investors (who are often the subject of restrictive national marketing rules). The distribution of AIFs is subject to MiFID II, which differentiates between retail and professional investors. Therefore, any change to the definitions of the types of investors in the AIFMD needs to take into account the interaction between the AIFMD and MiFID II.

In relation to third-country entities, the report acknowledges that national private placement regimes (NPPRs) are an important factor in market development, given that the passport for third-country entities has not been activated. NPPRs differ across Member States, but do not generally require firms to comply with as many requirements as under the AIFMD. This can lead to an un-level playing field between EU and non-EU AIFMs. A variety of opinions and stances exist across the EU on third-country access. While some advocate harmonising NPPRs, others favour activating the third-country passport and phasing out NPPRs. And certain Member States have prevented access entirely by third-country AIFMs.

Impact on investors

According to the report, the AIFMD depositary regime is functioning well, but "targeted clarifications" might be needed to address situations in which AIFMs use tri-party collateral management, or when central securities depositories act as custodians. The Commission also notes that a lack of a depositary passport is at odds with the spirit of the single market.

Rules on disclosures have increased transparency, however, the report notes that some investors request information other than that prescribed by the AIFMD.

The report also highlights the fact that the AIFM passport allows marketing only to professional investors, and not, for example, retail investors.

Impact on monitoring and assessment of systemic risk

The Commission did not find any evidence that suggests AIFMD thresholds of assets under management, above which the activities of AIFMs may pose significant systemic risk, require adjustment.

The report also mentions that the expansion of non-bank lending raises financial stability concerns but that some granular information on certain assets classes (such as leveraged loans and collateralised loan obligations) is currently missing but relevant for macro-prudential oversight. Some have called for the Commission to reassess whether there is a case for setting common standards for loan-originating AIFs.

Impact of rules on investment in private companies

The report found that transparency requirements (the so-called "portfolio company provisions") and provisions that prevent asset stripping are not "overtly burdensome".

The AIFMD requires the Commission, if appropriate, to put forward any proposals for change, including amendments to the AIFMD.

MiFID II: ESMA Technical Advice on Impact of Inducements and Costs and Charges Disclosure Requirements

On 1 April 2020, ESMA published a final report (dated 31 March 2020) to the European Commission setting out its technical advice on the impact of:

- The second paragraph of Article 24(9) of MiFID II on the inducements disclosure regime
- Article 24(4)(c) of MiFID II on the costs and charges disclosure regime

The final report summarises the feedback received to the Call for Evidence published by ESMA on 17 July 2019 and the rationale behind ESMA's final proposals.

Inducements Disclosure Requirements

In the final report, ESMA encourages the European Commission to conduct further analysis on the topic of inducements, which is key for the protection of investors, and proposes some changes to the regime mainly aimed at improving the clients' understanding of inducements. ESMA recommends that the Commission:

- Clarifies that the ex-ante and ex-post inducements disclosures should always be made on an ISIN-by ISIN basis thereby showing clients where the firm is most incentivised to recommend and sell a product
- Introduces the obligation to include, in all inducements disclosures, a simple and clear explanation of the terms used to refer to inducements (for instance, third-party payments). Such explanation should be sufficiently clear and use simple terms to ensure that retail clients understand the nature and impact of inducements
- Strengthens the MiFID II requirements around quality enhancing services. Firms should bring to their clients' attention the specific quality enhancing services that they are already benefiting from or that they could benefit from if they requested or used the service

Costs and Charges Disclosure Requirements

The final report states that the MiFID II costs and charges disclosure regime generally works well and that it helps investors make informed investment decisions. However, ESMA advises that some disclosure obligations vis-à-vis eligible counterparties and professional investors are scaled back:

- Eligible counterparties should be allowed to opt-out of the costs and charges disclosure regime (ex-ante and ex-post). Firms should keep records of the requests of opt-out.
- Professional clients should be allowed to opt-out of the MiFID II costs and charges disclosure regime provided that they receive services other than portfolio management and investment advice.
- For retail clients and eligible counterparties and professional clients who do not opt-out of the MiFID II costs and charges disclosure requirements, the existing regime has proven effective and should be kept in place (with certain amendments).

ESMA does not consider that the creation of a new sub-category of clients ("sophisticated retail clients") is required for the purposes of the inducements and costs and charges regimes.

Other elements of the report relate to trading by telephone and the provision of information to clients in a durable medium.

Whilst at this stage these are only recommendations by ESMA and any changes will require legislative action, private banks should be aware of this technical advice and the impact it could have on the information they may need to provide to clients.

FCA Publishes Discussion Paper on New UK Prudential Regime for MiFID Investment Firms

On 23 June 2020, the FCA published a Discussion Paper (DP20/2) on a new UK prudential regime for MiFID investment firms.

The Investment Firms Regulation (IFR) and the Investment Firms Directive (IFD) introduce a new prudential regime for EU investment firms that Member States must implement by 26 June 2021. The UK does not intend to implement the IFR and the IFD, and will instead establish a new Investment Firms Prudential Regime (IFPR). The IFPR is intended to achieve similar outcomes as the IFD and IFR while taking into consideration the specifics of the UK market. (See FCA Consults on Post-Brexit Prudential Regime for Investment Firms.)

The UK does not intend to implement the IFR and the IFD, and will instead establish a new Investment Firms Prudential Regime.

In the Discussion Paper, the FCA sets out details of the new EU prudential regime for investment firms and seeks feedback on the approach it should take for designing the IFPR. The FCA has commented that:

- The prudential regime would be simplified by replacing the existing prudential categories with the IFR/IFD categories of "investment firms" and "small and non interconnected investment firms (SNIs)". The FCA is also considering applying the IFPR to collective portfolio management investment firms.
- The IFR requirements on liquidity are proportionate, but should be recognised by investment firms as a baseline. An investment firm may need to meet additional liquidity standards as a consequence of the review process.
- If the FCA were to adopt a similar approach to the IFD remuneration requirements, the FCA would delete the IFPRU and BIPRU Remuneration Codes and create a new remuneration code based on the IFD.
- The FCA intends to apply similar transitional arrangements to those set out in the IFR and the IFD.

The deadline for responses is 25 September 2020. The FCA intends to publish a consultation paper on the IFPR later in 2020.

EBA: Q&A Tool

On 17 June 2020, the EBA announced that it has expanded the scope of its Q&A tool to enable the submission of questions on MLD4 and Consumer Protection legislation under the EBA's scope.

The EBA has also made some changes to expand and update its online Interactive Single Rulebook.

The EBA will publish the submitted questions on its website, subject to meeting the prescribed criteria, while it prepares the answers. At the same time, the EBA has also made some changes to expand and update its online Interactive Single Rulebook. This is already a useful tool for Q&A on PSD2 and a number of critical rule interpretations have come out as a result of these Q&A. Private banks should note, however, that the Q&A are not legally enforceable.

BMR: HM Treasury Announces Proposed Amendments to the UK Benchmarks Regulation

On 23 June 2020, the FCA published a statement welcoming HM Treasury's announcement that the Treasury intends to bring forward legislation to amend the onshored UK version of the EU Benchmarks Regulation (UK BMR). Under the proposed changes, the FCA would have enhanced powers to ensure an orderly wind-down of critical benchmarks where the FCA has found that the benchmark's representativeness will not be restored. These changes will be particularly helpful in the context of the LIBOR transition.

Where particular users are unable to amend "tough legacy" contracts to move away from LIBOR, the FCA would have the power to direct the administrator of LIBOR to change the benchmark's methodology, if doing so would protect consumers and market integrity. This would allow limited continued use of LIBOR in legacy contracts during a wind-down period. There are some limitations to this approach, however. Such regulatory action to change the LIBOR methodology may not be feasible in all circumstances, for example where the inputs necessary for an alternative methodology are not available in the relevant currency. Further, parties relying on such regulatory action will not have control over the economic terms of that action and, as different approaches and rates will be appropriate for different product classes and users, a single methodology change may not have the desired effect for all markets.

Whilst the proposed changes are helpful, the FCA's statement encourages market participants to continue focusing on active transition in order to ensure certainty about contractual continuity. The FCA also encourages market participants to retain control over their contractual terms when LIBOR ceases or is no longer representative, including through the use of market-standard documents such as those produced by the International Swaps and Derivatives Association.

In another statement made on the same day, HM Treasury announced that it would be amending the UK BMR to ensure continued market access to third country benchmarks until end-2025. A policy statement is expected in July 2020.

LIBOR: Transition and Tough Legacy Contracts

On 29 May 2020, the RFRWG, through its "Tough Legacy Taskforce", released a paper on identification of tough legacy issues and proposals for dealing with them in relation to derivatives, bonds, loans and mortgages, with specific proposals in relation to each asset class. Tough legacy contracts are broadly considered to be those contracts in which active transition from LIBOR is not possible, because they do not have robust fallbacks and cannot be amended in advance of LIBOR discontinuation.

Primarily, the Taskforce proposes a legislative solution to address tough legacy exposures in contracts governed by English law that reference at least sterling LIBOR, and ideally other LIBOR currencies, that are still in operation when LIBOR is expected to cease on or after the end of 2021. The Taskforce refers to the work currently being undertaken by the ARRC for a legislative proposal under New York law. The Taskforce acknowledges that there are challenges and dependencies that would need to be resolved in delivering a legislative solution and suggests that other solutions should be pursued in parallel, including:

- Co-operation across jurisdictions for a joined-up, global approach to transition
- A "synthetic" methodology for LIBOR for a wind-down period beginning after the end of 2021, following the ceasing of panel bank contributions
- Careful consideration of triggers, economics, and legal implications for market participants of any solution
- Active transition from LIBOR wherever possible, given the challenge with any "one size fits all" solution
- Careful consideration of tax, regulatory, and accounting consequences of any solution to ensure they are addressed through the existing work of the official sector and relevant standard-setting bodies

Private banks should therefore consider this paper and take it into account in their LIBOR transition plans.

LIBOR: Update on Transition Timing

On 25 March 2020, the FCA, Bank of England, and members of the Sterling RFR Working Group (RFRWG) issued a statement on the impact of COVID-19 on firms' LIBOR transition planning. This statement confirmed that there is no change to the assumption that firms cannot rely on LIBOR being published after the end of 2021 and that this should remain the target date for all firms to meet.

The statement however did acknowledge that COVID-19 had impacted the timing of some aspects of the transition programmes, that more progress in transition would have been made had COVID-19 not occurred, and that there would likely be an impact on some of the interim transition milestones.

Following on from this, the RFRWG published a further statement on 29 April 2020, updated on 13 May 2020, on the impact of COVID-19 on LIBOR transition. This statement acknowledged the challenges presented by the current operating environment, but noted that the RFRWG has continued to see progress on LIBOR transition. In particular, the RFRWG noted that:

- Progress has been made in the sterling cash markets
- The transition to SONIA in the bond market has been largely completed
- Lenders continue to work to make SONIA-based products available in the loan market before the end of Q3 2020, with some borrowers ready to take advantage of these alternative products before then

The statement does, however, note that the RFRWG, the FCA, and the Bank of England recognise that given the COVID-19 environment, meeting the existing end-Q3 target to complete the transition away from LIBOR across all new sterling LIBOR linked loans will not be feasible. It also acknowledges that there will likely be continued use of LIBOR-referencing loan products into Q4 2020 in particular, to maintain the smooth flow of credit to the real economy. The RFRWG recommends that:

- By the end of Q3 2020 lenders be in a position to offer non-LIBOR linked products to their customers
- After the end of Q3 2020 lenders, working with their borrowers, include clear contractual arrangements in all new and re-financed LIBOR-referencing loan products to facilitate conversion ahead of end-2021, through pre-agreed conversion terms or an agreed process for renegotiation, to SONIA or other alternatives
- All new issuance of sterling LIBOR-referencing loan products that expire after the end of 2021 cease by the end of Q1 2021

Private banks should also be aware that once plans and working arrangements disrupted by COVID-19 begin to stabilise, the RFRWG has stated that it will intensify communication with customers needing to move away from LIBOR as part of transition and firms should be prepared to present updated, current versions of their LIBOR transition plans to the regulators when requested.

The Chair of the RFRWG, the FCA, and the Bank of England will continue to work with members of the RFRWG and international counterparts to assess the evolving impact of COVID-19 on firms' LIBOR transition efforts, and provide further updates in due course.

FCA Sets Out Next Steps to Improve Defined Benefit Transfers

On 5 June 2020, the FCA set out next steps to improve the defined benefit pension transfer market. These steps include a package of measures designed to address weaknesses identified by the FCA across the defined benefit transfer market. The FCA published its final rules and guidance on pension transfer advice (PS20/6), together with feedback on its previous consultation.

In PS20/6, the FCA sets out a package of measures to:

- Require firms to consider a workplace pension scheme as a destination for a transfer
- Ban contingent charging for advice on pension transfers and conversions in order to reduce conflicts of interest, except in specific circumstances where a consumer is more likely to benefit from advice and may be unable to afford non-contingent advice charges
- Enable firms to give a short form of advice ("abridged advice")
- Provide guidance on "triage services" that do not amount to advice
- Empower consumers to make better decisions by improving how advisers disclose charges and requiring checks on consumers' understanding during the advice process
- Enable advisers to give better-quality advice and improve professionalism by introducing specific continuing professional development for pension transfer specialists
- Require advice firms to submit new data to improve the FCA's ability to supervise the sector
- Amend technical areas of the FCA rules and guidance to clarify and extend existing requirements

The changes to triage services and using estimated transfer values came into effect on 15 June 2020 and the remainder come into force on 1 October 2020.

Concurrently, the FCA issued a press release stating that the number of customers who are advised to transfer their investments out of gold-plated final salary-type pension schemes remains "unacceptably high". The press release notes that while much of the advice the FCA reviewed was suitable, the FCA still found too many cases in which transfers were not in the customer's best interests. The FCA is also investigating 30 firms in relation to pension transfer advice. These investigations will provide examples of the advice the FCA considers inappropriate, as the FCA seeks to help other advisors operating in the market.

The FCA has also launched a consultation (GC20/1) on guidance on what the FCA expects from firms when advising on pension transfers and conversions, particularly from defined benefit schemes to defined contribution schemes. This consultation sets out best practice and case study examples of suitable and unsuitable advice. The consultation closes on 4 September 2020.

To the extent that private banks are or have been engaged in the defined benefit transfer market, they should note these changes and consider the FCA's comments should any reviews of pension transfer advice occur.

Lessons From Enforcement: FCA Fines Bank Over Anti Money Laundering Failures

On 17 June 2020, the FCA fined Commerzbank AG (London Branch) £37,805,400 for failing to implement adequate anti money laundering (AML) systems and controls between October 2012 and September 2017.

Commerzbank London was aware of the weaknesses of its AML systems and controls, and failed to take reasonable and effective steps to fix them, despite the FCA raising specific concerns on several occasions.

The weaknesses in Commerzbank London's AML systems and controls continued during a period when the FCA was publishing guidance on steps firms could take to reduce financial crime risk and taking enforcement action against a number of firms in relation to AML controls.

Firms operating in the UK, including branches of overseas firms, must take reasonable care to organise and control their affairs responsibly and effectively, and to establish and maintain an effective risk based AML control framework.

The FCA's investigation identified failings in a number of areas, including Commerzbank London's failure to:

- Conduct timely periodic due diligence on its clients, which resulted in a significant number of existing clients not being subject to timely know-your-client checks
- Address long standing weaknesses in Commerzbank London's automated tool for monitoring money laundering risk on transactions for clients
- Have in place adequate policies and procedures when undertaking customer due diligence

Commerzbank therefore breached Principle 3 of the FCA's Principles for Businesses, which requires firms to implement adequate risk management systems.

Commerzbank London has undertaken a significant remediation exercise to bring its AML controls into compliance. It has also conducted an extensive look back exercise to identify suspicious transactions during the period in question. Commerzbank London also voluntarily implemented a wide ranging business restriction, which included a temporary halt on taking on new high risk customers and the suspension of all new trade finance business activities.

This enforcement fine serves as a reminder to private banks on the importance of establishing and maintaining effective systems and controls for the prevention of money laundering and financial crime.

Global Insights: Hong Kong

SFC and HKMA to Conduct Thematic Review of Intermediaries Spread Charges and Other Practices

On 18 May 2020, the Securities and Futures Commission (SFC) published a circular to inform the public that the SFC and the Hong Kong Monetary Authority (HKMA) will commence a concurrent thematic review of intermediaries' spread charges and other practices in the second half of 2020. The review will cover the selected intermediaries' policies, procedures, systems, and controls as well as management oversight of the distribution to clients of non-exchange-traded investment products.

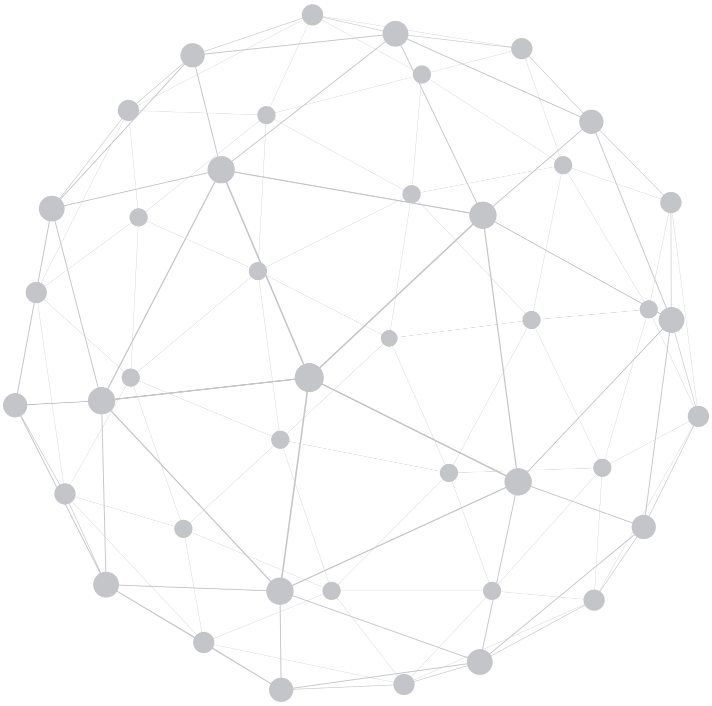
The review aims to ascertain whether: (i) charges may be in excess of the spreads or fees disclosed in the intermediaries' standard documents to clients; (ii) spreads may be increased after a trade is executed and the price improvement is retained without agreement with or disclosure to clients; and (iii) intermediaries properly disclose their trading capacity when conducting trades for clients.

The circular also sets out the level of skill, care, and diligence that intermediaries should exercise. For example, intermediaries are expected to: (i) implement appropriate policies and systems over order handling and spread charges; (ii) properly disclose fees and trading capacity; and (iii) maintain adequate records to ensure compliance with internal policies and regulatory requirements.

The SFC and the HKMA will assess intermediaries' compliance and take regulatory action, in the event of breach, based on the findings of the concurrent thematic review.

Private banks operating in Hong Kong should consider whether they have the appropriate policies, systems, and controls in place.

TechTrends: European Parliament Calls for New EU Common Framework for Cryptoassets



On 4 June 2020, the European Parliament's Economic and Monetary Affairs Committee (ECON) published a draft report setting out its recommendations to the European Commission on digital finance, including emerging risks in cryptoassets and regulatory and supervisory challenges in the area of financial services, institutions, and markets.

The draft report addresses the main areas that demand a pan-European regulatory response to digital finance. Three priority areas are highlighted for consideration for legislative action: cryptoassets, cyber resilience, and data. These areas are noted as key to the future development of digital finance in the EU.

ECON emphasises that law and supervision in the area of fintech should be based on the following principles:

- The same services and their associated similar risks should be subject to the same rules
- Technology neutrality
- A risk-based approach

The draft report states that European financial entities, and in particular fintechs, require a comprehensive and stable regulatory framework to expand their activities and operate with legal certainty. It also highlights the need for the Commission to work closely with international organisations and regulatory bodies to develop international standards, given the cross-jurisdictional nature of digital finance.

Three priority areas are highlighted for consideration for legislative action: cryptoassets, cyber resilience, and data. These areas are noted as key to the future development of digital finance in the EU.

Cryptoassets

ECON recommends that the Commission put forward a legislative proposal for cryptoassets, to provide legal certainty for the treatment of cryptoassets while ensuring consumer and investor protection. It also suggests that the Commission develop a taxonomy concerning cryptoassets, starting with a common definition. Any pan-European taxonomy for cryptoassets should be open-ended, since cryptoassets are likely to significantly evolve over the coming years. This likely evolution also means that regulators need to develop a flexible regulatory approach to cryptoassets while still providing regulatory certainty as soon as cryptoassets are issued.

With regards to scope, the draft report notes that "applying existing regulations to previously unregulated crypto-assets will be necessary, as will creating bespoke regulatory regimes for evolving crypto-asset activities, such as initial coin offerings".

Cyber resilience

ECON calls on the Commission to make a legislative proposal in the area of ICT and cybersecurity requirements for the EU financial sector in order "to address any inconsistencies, gaps and loopholes that are found to exist in relevant law".

These legislative changes should focus on the following four key areas:

1. Modernisation
2. Alignment of reporting rules as regards ICT incidents
3. A common framework for penetration and operational resilience testing across all financial sectors
4. Oversight of critical ICT third-party providers

The draft report also emphasises the need for greater information sharing, in particular on incidents, and enhanced coordination between relevant regulatory and supervisory authorities.

Data

ECON asks the Commission to examine how to ensure that digital finance entities can access relevant and useful data to enable fintech businesses to grow and also requests that the Commission consider a framework for digital onboarding and the use of digital identities, with the aim of harmonising these measures across the EU. In addition, the draft report highlights the increasing use of customer data (or Big Data) and calls for enhanced oversight in this area.

The draft report notes that "applying existing regulations to previously unregulated crypto-assets will be necessary, as will creating bespoke regulatory regimes for evolving crypto-asset activities, such as initial coin offerings".

Next steps

The Commission has committed to finalise the FinTech Action Plan by Q3 2020, and ECON's draft report encourages the Commission to adhere to that timeframe.

What to Look Out for in Q3 2020

- Joint Committee of the ESAs expected to submit its proposed amendments to the PRIIPs KID RTS to the European Commission for endorsement (delayed due to COVID-19)
- Feedback to be received on the delegated acts amending MiFID II, AIFMD, UCITS Directive, Solvency II, and the IDD and facilitating the implementation of the SFDR
- End of feedback period for the draft RTS on ESG disclosures pursuant to the SFDR
- ESMA expected to report on various aspects of the MiFID II review
- ESMA expected to submit its Final Report to the Commission on MAR (delayed due to COVID-19)
- Commission to finalise the FinTech Action Plan
- HM Treasury to publish more information on the UK BMR and PRIIPs regime in the UK

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