WHITE & CASE

Financial Regulatory Observer

The *Financial Regulatory Observer* spotlights selected topics currently driving regulatory and technological changes in the financial industry.

Autumn 2021

Winning the AML intelligence war with public-private partnerships

Key considerations for banks engaging with governments and peer institutions to improve financial crime compliance systems

By Jonah Anderson, Kristen DiLemmo and David Schoo (Jeremy Kuester contributed to the development of this article)

Every year, banks spend billions of dollars on core financial crime compliance systems and are filing more suspicious activity reports (SARs) than ever. Despite these process improvements, the global anti-money laundering (AML) regime does not appear to be substantially more effective. Innovative public-private partnerships (PPPs) have demonstrated some success in meeting government objectives, but is the system manifestly better for banks? We explore key considerations for banks engaging with their governments and their peers in AML PPPs, with a particular focus on the UK, the US and Germany.

IMPROVING AML EFFECTIVENESS THROUGH PPPS

The global AML regime is decades old, built on international standards, national legislation and multibillion-dollar enforcement actions. Yet, for all of those efforts, questions still remain as to the effectiveness of SARs—one of the keystone initiatives of the global AML regime.[1]

Financial institutions and other reporting entities collectively spend many billions of dollars annually to produce millions of SARs.[2] In addition, the number of SARs filed has increased significantly each year. For example, Figure 1 shows how SAR filings in the UK, the US and Germany have grown over the past three years.

At the same time, surveys of past and present heads of national financial intelligence units (FIUs) indicate that only a relatively small handful of SARs are of immediate value to law enforcement.[5]

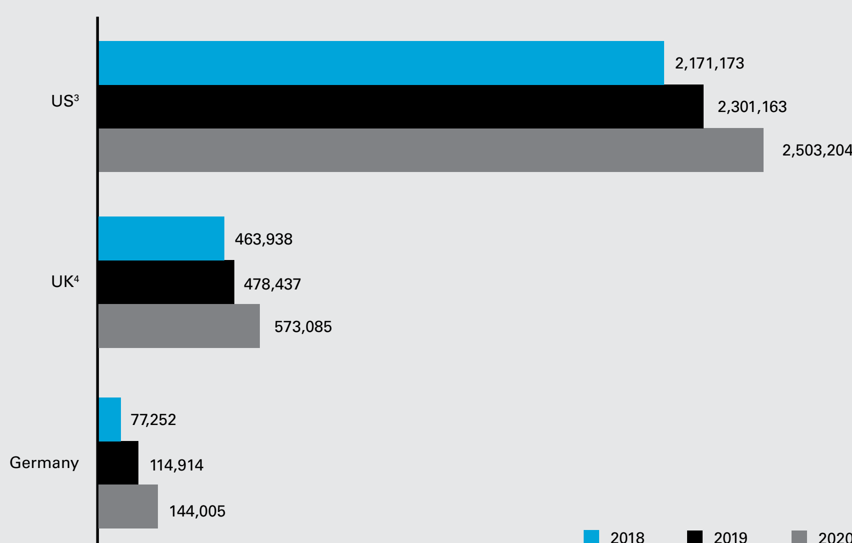
Of course, a report that is not of immediate value could still become valuable in the future, as investigations often develop over the course of many months and years. Moreover, some FIUs data-mine all of their SARs to uncover trends and typologies or to develop new insights into networks that are only made clear after the SAR is placed in context. Still, this low return on investment is frustrating to both governments and reporting institutions and has driven a wave of reform designed to improve the usefulness or effectiveness of SAR reporting.

As of June 2020, at least 18 countries have developed PPPs (See Figure 2).

Some benefits from PPPs include:

- An increase in the number of suspicious reports addressing threats prioritized by the PPP
- More timely and relevant reporting in response to active investigations or live incidents
- Improved quality and utility of suspicious reporting
- Improved law enforcement outcomes supporting investigations, prosecutions, asset recovery or other disruption of criminal networks
- More collaborative and constructive relationships between relevant public agencies and regulated entities

Figure 1: Recent growth in SAR filings



- Heightened risk awareness in the private sector, including through the development of alerts and typologies
- Increased understanding in the public sector about complex financial issues or services and their vulnerabilities to abuse[6]

Here are examples of current PPPs in the UK, the US and Germany.

Successes in the UK

While informal dialogue between law enforcement agencies and financial agencies has nearly always existed in many jurisdictions, a structured approach to that dialogue is a relatively recent innovation that was pioneered in the UK with the Joint Money Laundering Intelligence Taskforce (JMLIT). The JMLIT, created in 2015, now comprises the following:

- More than 40 financial institutions
- The Financial Conduct Authority
- Cifas (the UK fraud prevention service)
- Five law enforcement agencies: the National Crime Agency, Hey Majesty's Revenue & Customs, the Serious Fraud Office, the City of London Police and the Metropolitan Police Service

Since its inception, the JMLIT has supported and developed more than 750 law enforcement investigations, which directly contributed to more than 210 arrests and the seizure or restraint of more than £56 million. JMLIT private sector members have identified more than 5,000 suspect accounts linked to money laundering activity and commenced more than 3,500 of their own internal investigations.[7]

Beyond these statistics, the 2018 UK Financial Action Task Force (FATF) mutual evaluation report gave two specific examples of the JMLIT's success. These examples focus on terrorism financing matters and relate to the two terrorist attacks on London in 2017. The JMLIT's assistance allowed law enforcement to rapidly obtain a full financial picture of the attackers and, in relation to one of the attacks, establish that there was no broader network beyond the three attackers.[8] FATF also noted that one request by law enforcement agencies through the JMLIT can obtain information from multiple financial institutions, which is very efficient for them in terms of developing a comprehensive intelligence picture. SARs that follow such a request are considered to be of a very high standard.

The JMLIT sits within the National Economic Crime Centre (NECC), which coordinates and tasks the UK's response to economic crime and is intended to harness intelligence and capabilities from across the public and private sectors to tackle economic crime in the most effective way. The NECC launched in October 2018 and includes various law enforcement agencies and the Home Office. As the NECC evolves, it will build wider partnerships with the private sector.

Introduction in the US

In December 2017, the US Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) formalized its PPP, the FinCEN Exchange.[9] FinCEN, in close coordination with law enforcement, convenes regular briefings with financial institutions to exchange information on priority illicit finance threats, including targeted information and broader typologies. Its goal is to enable financial institutions to better identify risks and focus on high-priority issues and to help FinCEN and law enforcement receive critical information supporting their efforts to disrupt money laundering and other financial crimes. It is a voluntary, invitation-based program, where participating financial institutions are selected based on their relevance to the topic of that particular exchange. The FinCEN Exchange grew out of more than a dozen special briefings since 2015 in five cities with more than 40 financial institutions and multiple law enforcement agencies that helped the public sector map out and target weapons proliferators, sophisticated global money laundering operations, human trafficking and smuggling rings, corruption, trade-based money laundering networks and other illicit actors.

More than
40
financial institutions are in the UK JMLIT

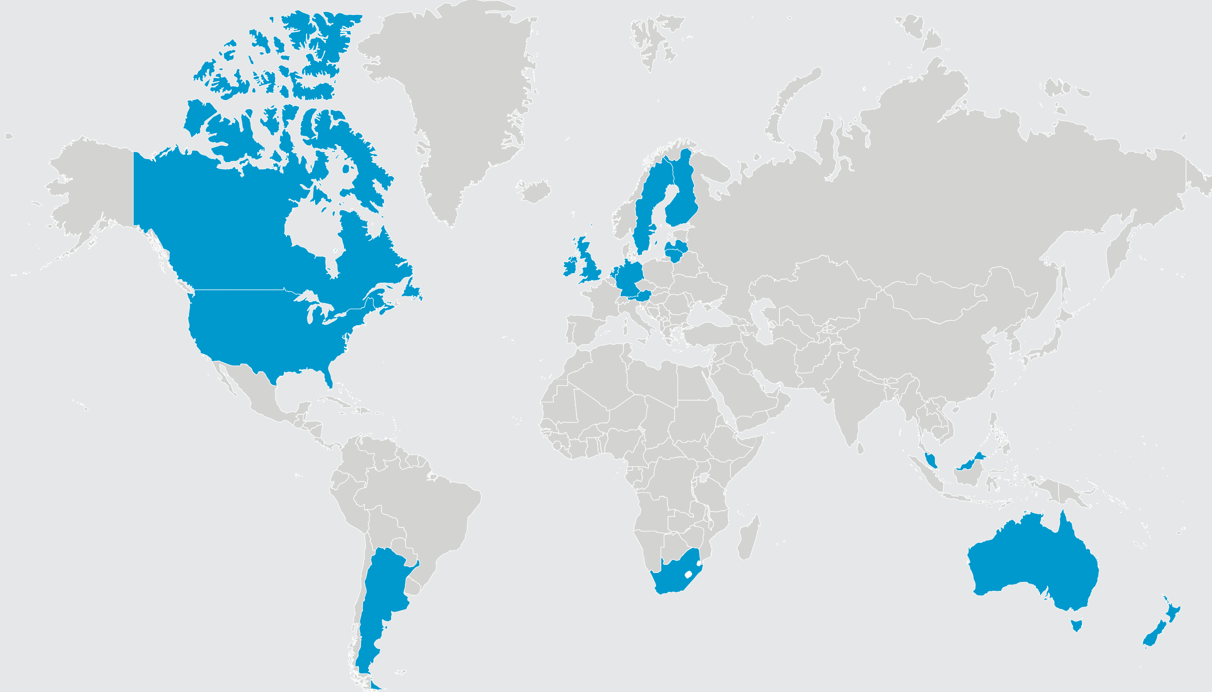
Introduction in Germany

Germany established a PPP in September 2019 in order to intensify cooperation between the authorities and private sector institutions involved in preventing and combating money laundering. Germany's Anti Financial Crime Alliance (AFCA) aims to facilitate an intensive and lasting exchange of information from the public and private sectors to jointly identify new trends and developments and optimize potential for the reporting of suspected money laundering. To date, this national form of cooperation is unique in the field of financial crime in Germany.

The AFCA's Board, composed of an equal number of public sector representatives and private sector reporting entities, is responsible for the AFCA's overall strategic orientation and is advised by a team of experts. The AFCA's structure follows a partnership-based approach with equal input from all participants, allowing for strategic exchanges related to problems and issues between government institutions and the private sector. During AFCA's first year of work, the number of members has more than doubled to 36, including members from both inside and outside the financial sector. The Management Office incorporated in the German FIU is the main interface between the various participants, users and the AFCA Board. The operational core is formed of working groups, which meet regularly, have clear time limits and are demarcated by their subject matter. Initially, two working groups were set up:

1. Principles of cooperation—Deals with issues relating to the further development of rules and methods of cooperation within the AFCA, such as the further development of the founding documents or the elaboration of operational processes for shaping cooperation between the working bodies or the preparation of statements on issues relating to the functioning of the AFCA
2. Risks and trends in the area of money laundering and terrorism financing in the financial sector — Participants exchange views on facts regarding specific phenomena and topics of common interest relevant to suspicious transaction reporting

Figure 2: Countries with AML PPPs



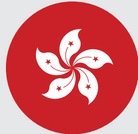
United Kingdom

United States

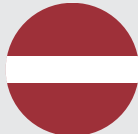
Ireland

Australia

Singapore


Hong Kong

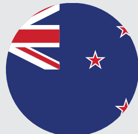
Netherlands


Latvia

Malaysia

South Africa

Sweden


New Zealand

Finland

Lithuania

Argentina

Germany

Austria

Canada

Source: Royal United Services Institute (RUSI) Future of Financial Intelligence Sharing (FFIS), "Survey Report: Five years of growth in public–private financial information-sharing partnerships to tackle crime," Aug. 2020, p. 19.

In addition to these initial working groups, three more subject matter-focused working groups have been set up in the course of 2020 covering: (1) money laundering in the real estate sector; (2) tax offenses; and (3) gambling.

In late 2020, the AFCA also established an expert panel that consists of high-ranking representatives from the public and private sector as well as a legal expert from the academic community. The expert panel advises the Board regarding the strategic objectives of the AFCA, as well as analyzing and evaluating the results of the working groups.

Despite continuous progress, the AFCA is not yet able to stand in comparison with similar initiatives in other countries, such as the JMLIT. One key obstacle in its work is the lack of a framework that would allow all AFCA members to exchange detailed information of individual transactions without risking violations of data protection requirements. This conflict of interest between data protection concerns and money laundering prevention ultimately has to be resolved by the legislator.

BANK OBJECTIVES FOR AML PPPS

The advent of AML PPPs appears to have successfully achieved many government objectives, but do PPPs similarly benefit private sector participants, particularly multinational banks that may be involved in several national PPPs? Are AML PPPs also meeting banks' objectives, or do they simply create another additional obligation for banks?

To date, many banks willingly participated in AML PPPs.[10] Typically, in addition to altruistic reasons, they seek to:

1. Minimize the risk of an enforcement action against the bank for AML failures
2. Achieve cost efficiencies in their AML compliance function without substantially increasing their enforcement risks
3. Avoid reputational damage that is often associated with money laundering violations

We have also heard from many bank executives that if banks are required to maintain expensive AML systems to identify and report suspicious activities, they want to know that those reports at least have some value to law enforcement and other stakeholders. Whatever the objectives pursued by bank participants in a PPP, for the PPP to be a long-term success, those objectives must be pursued as diligently as any of the government's objectives.

AML effectiveness

Through a PPP, government authorities can provide more detailed typologies—or even details of specific organized crime groups and their members—that would otherwise compromise investigations, if that information were released more broadly. This allows banks to leverage the rich pools of data to which they have access with greater focus and intention, building and reporting connections that might not otherwise be suspicious. The return on investment for PPP-driven SAR investigations is also significantly higher than for self-generated SAR investigations. In the latter circumstance, once the SAR is filed, it may often feel as if the SAR was submitted directly into a black hole, with little acknowledgement that the SAR exists, let alone is useful. However, because of the involvement of the PPP, a bank that files PPP-driven SARs knows that the government is immediately interested in such information and often will take action on the information filed by the bank.

For all of the attention placed on information-sharing, many of the national-level PPPs share some significant deficiencies in cross-border information-sharing. For example, very few of the national-level PPPs coordinate with their foreign peers. This a major weakness when considering the cross-border nature of many of the topics addressed by PPPs, such as terrorism finance, narcotics trafficking, modern slavery and other transnational crimes. Moreover, the different priorities pursued between the national-level PPPs can diffuse the focus of multinational banks that may be engaged in several different PPPs at the same time, undercutting potential improvements to AML compliance efficiency.

Similarly, national-level PPPs often impose confidentiality requirements or non-disclosure agreements—along with strict SAR confidentiality requirements—that in some jurisdictions may limit a bank's ability to share information across its enterprise, particularly with foreign branches, subsidiaries or affiliates. This may limit a multinational bank's ability to exploit all of its data, see different aspects of cross-border relationships, derive more meaningful AML typologies that are specific to that bank and manage enterprise-wide risks.

Cost of compliance

Ideally, a bank's involvement in a PPP could result in efficiencies in its AML investigatory and reporting function. The PPP would set priorities for the bank, which would enable the bank to shift resources from lower-priority efforts to higher, more valuable, priorities. Unfortunately, to date, AML supervisors have generally not authorized such re-prioritization of resources, and participating in a PPP is an additional expense for many banks. To participate in a PPP, a bank would generally commit to engage in deeper, retrospective analyses of its account and transaction base and potentially promulgate bespoke rules for its transaction monitoring systems, all of which would be in addition to the bank's business-as-usual AML compliance function to meet its baseline regulatory requirements.

Several initiatives are underway to improve the effectiveness of PPPs and the global AML regime.

Reputation

In theory, a bank engaged in a PPP would be able to use such involvement to boost its credentials as a responsible corporate citizen (and improve its environmental, social and governance (ESG) ratings). However, the nature of PPPs is to share information with and from the government that is otherwise sensitive or confidential. As a result, a bank may be extremely restricted as to what it can disclose about its activities in support of the PPP. Without concrete details it can point to, a bank's involvement in a PPP is esoteric and does not easily translate to a reputational asset.

Banks, particularly those with the highest public profiles, will continue to be willing participants in PPPs in the near to mid-term. However, if PPPs become one-sided, only providing tangible benefits to the public sector, voluntary participation by banks and other financial institutions may wane.

IMPROVING THE EFFECTIVENESS OF PPPS

Fortunately for all concerned, a number of initiatives are underway to improve the effectiveness of PPPs particularly and for the global AML regime generally.

Government initiatives—including implementation of even more innovative approaches to PPPs and new laws and regulations that further break down barriers to collaboration—hold great promise for financial institutions. Banks can also take a number of steps to ensure that their participation in PPPs returns the greatest value.

Government efforts

Europol's Financial Intelligence PPP (EFIPP)

While not specifically designed to address concerns of competing priorities among national-level PPPs, the PPP created by Europol demonstrates the advantages of a multinational PPP. EFIPP is constituted of:

- Public authorities from 12 EU member states, Australia, Switzerland and the US
- 25 internationally focused financial institutions
- Representatives from national and EU supervisors

EFIPP has developed detailed typologies, including geographical indicators, on a wide range of topics, including organized crime, criminal and money laundering trends, financial flows related to "laundromats," virtual currencies, terrorism financing, tax fraud and COVID-19 related fraud.[11] Of additional note, an EFIPP working group has conducted a mapping exercise on legal gateways to share information within a financial institution (intra-group), between EU member states and countries with equivalent personal data-protection rules, and with countries with non-equivalent personal data-protection rules.[12]

18

countries with AML PPPs

Enterprise-wide SAR sharing

US regulators have allowed branches and subsidiaries of certain non-US financial institutions to share SARs generated in the US with their non-US parent or head office.[13] However, it was only after the passage of the January 2021 Anti-Money Laundering Act that US-headquartered financial institutions had an opportunity to share SAR information with their overseas affiliates through a required pilot program.[14] To further encourage information-sharing, this Act also granted SARs filed under non-US regimes the same confidential status as if the SAR had been filed in the US.[15]

The UK has made an effort in recent years to facilitate SAR information-sharing between UK-regulated entities. The Criminal Finances Act 2017 introduced a mechanism[16] by which regulated banks and financial institutions can share information about suspected money laundering in conjunction with the UK FIU. This allows for the submission of joint disclosure reports (referred to as "super SARs"), with the aim of providing a fuller picture of the suspected activity to enforcement agencies. This significantly broadened the permissible disclosure regime in the UK, which primarily focused on intra-group disclosure.[17]

Similarly, Germany has implemented certain exceptions to the prohibition on disclosure of information in SAR filings, which are intended to facilitate the exchange of information with government agencies and other obliged parties for the purpose of preventing money laundering or terrorism financing. Information-sharing is allowed between obliged parties of the same group,[18] including between parent companies and their third-country subsidiaries, provided that the parent has implemented

group-wide money-laundering prevention measures.[19] In addition, obliged parties may, under certain conditions, share information with other EU or third-country obliged parties, provided they are involved with the same contracting party or the same transaction.[20] This is to enable the obliged parties to better assess risks, identify suspicious behavior and intervene in suspicious conduct before a money-laundering risk materializes.

Co-location of analysts

Australia and the Netherlands have developed interesting approaches to the PPP model, whereby analysts from the public and private sector work together on a daily basis. This model is expected to allow the participants to develop a stronger shared understanding of the threats posed by money laundering, terrorism financing and serious financial crime. Co-location also has tactical advantages, as it allows more agile collaboration among participants on time-sensitive cases. With such a tactical focus, this model also allows for more contemporaneous and more detailed feedback on specific SARs as they relate to current cases.

Prioritization of AML resources

In the past year, a movement has grown in the US to prioritize efforts in AML compliance, culminating in the passage of the Anti-Money Laundering Act, which requires the US government to identify national-level AML priorities that financial institutions must incorporate into their AML compliance programs.[21] While these priorities and their implementation must still be fleshed out through regulations, the expectation appears to be that financial institutions prioritize their limited resources on the national-level priorities.[22] To be at all effective, these priorities would also have to extend to how FinCEN Exchange (the US PPP) engagements are organized. Many financial institutions may find engagement in the FinCEN Exchange even more valuable, because the integration of priorities at a more tactical level will give even greater clarity as to where the financial institutions should prioritize their efforts and resources.

Practical considerations for banks

Even if a bank is not able to avail itself of the initiatives described above, there are several actions it can take to better leverage the capabilities of a PPP to meet its AML compliance objectives:

- **Share information to the fullest extent possible.** Whether the information is shared internally, across the bank's enterprise, with its peers or with the government, the opportunity to give and receive information will help to refine the bank's compliance approach to its most significant threats
- **Review latest guidance.** A side effect of information-sharing partnerships is that they can generate helpful guidance to assist all financial institutions, not just the members of the PPP
- **Re-tune transaction monitoring systems.** Involvement in a PPP will give a bank unique insights into the government's enforcement position with regards to certain issues. Re-tuning transaction monitoring systems can help ensure that the bank detects suspicious activities even with regard to new typologies and is reporting information the government would expect to see
- **Benchmark against peers.** Participating in a PPP will give a bank insight into the resources and compliance approach of its peers. This can be particularly valuable knowledge, as many bank supervisors re-evaluate what they consider to be "reasonable efforts" in AML risk management against innovations they observe among peer institutions

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1 Note that the requirement can also be referred to as a suspicious transaction report, but we focus on the slightly broader obligation to report suspicious activities.

2 *See*: British Banker's Association, "Response to Cutting Red Tape Review: Effectiveness of the UK's AML regime," Jun. 21, 2018, and Bank Policy Institute, "Getting to Effectiveness – Report on U.S. Financial Institution Resources Devoted to BSA/AML & Sanctions Compliance," Oct. 29, 2018.

3 FinCEN, "SAR Statistics," filings for all industries, available at https://www.fincen.gov/reports/sar-stats, reviewed on Jun. 7, 2021.

4 https://www.ebrd.com/news/speeches/putting-climate-and-the-environment-at-the-core-of-ebrd-activity.html

5 *See*, Nick J. Maxwell and David Artingstall, Occasional Paper, "The Role of Financial Information-Sharing Partnerships in the Disruption of Crime," Royal United Services Institute for Defence and Security Studies, Oct. 2017, p. vi; *see also*, for example, the 2019 annual report of the German FIU, p. 20, according to which only approx. one third of all SARs were disseminated to law enforcement authorities (compared to 58% in 2018); available here: https://www.zoll.de/DE/FIU/Fachliche-Informationen/Jahresberichte/jahresberichte_node.html

6 Royal United Services Institute (RUSI) Future of Financial Intelligence Sharing (FFIS), "Survey Report: Five years of growth in public-private financial information-sharing partnerships to tackle crime," Aug. 2020, p. 19.

7 Royal United Services Institute (RUSI) Future of Financial Intelligence Sharing (FFIS), "Survey Report: Five years of growth in public-private financial information-sharing partnerships to tackle crime," Aug. 2020, p. 19.

8 *See*, Financial Action Task Force, "Anti-money laundering and counter-terrorist financing measures: United Kingdom Mutual Evaluation Report," Dec. 2018, p. 92.

9 The National Defense Authorization Act of FY 2021, which was enacted in January 2021, codified the FinCEN Exchange in law at Section 6103.

10 While involvement in PPPs is generally voluntary, not every bank or financial institution may be given the opportunity to participate. Many PPPs only permit a relatively small number of financial institutions to participate, to keep costs low and protect the confidentiality of any information that is shared.

11 RUSI, p. 80.

12 RUSI, p. 81.

13 FinCEN, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, "Interagency Guidance on Sharing Suspicious Activity Reports with Head Offices and Controlling Companies," Jan. 20, 2006.

14 P.L. 116-283 § 6212.

15 P.L. 116-283 § 6109.

16 Section 11 of the Criminal Finances Act 2017 amended the Proceeds of Crime Act 2002 by inserting Sections 339ZB – 339ZG. *See*, White & Case LLP, "The Making of a Super-SAR: A Case Study," Feb. 1, 2018, and Home Office Circular: Criminal Finances Act 2017, "Money Laundering: Sharing of Information within the Regulated Sector."

17 Per sections 333B-333D of the Proceeds of Crime Act 2002.

18 Sec. 47 (2) no. 2 German Money Laundering Act (Geldwäschegesetz, GwG).

19 Sec. 47 (2) no. 3 GwG.

20 Sec. 47 (2) no. 5 GwG.

21 P.L. 116-283 § 6101.

22 On June 30, 2021, FinCEN released its priorities, which include: corruption; cybercrime, including relevant cybersecurity and virtual currency considerations; foreign and domestic terrorism financing; fraud; transnational criminal organization activity; drug trafficking organization activity; human trafficking and human smuggling; and proliferation financing. FinCEN, "Anti-Money Laundering and Countering the Financing of Terrorism National Priorities," June 30, 2021.

Fintech solutions for the financial services sector

Challenges and opportunities in the US, the UK and Europe

By Douglas Landy, Jonathan Rogers, Dr. Carsten Lösing and Harriet Baldwin

The digital revolution was well underway long before most of us had ever heard of COVID-19. Yet, as a consequence of the pandemic, life went online in a way that we had never before experienced, and the whole world was suddenly focused on the importance of digital services and solutions. This digital acceleration and increase in demand for Fintech solutions presents challenges and opportunities for the financial services sector. In this article, our teams in the US and Europe consider recent trends and developments in the Fintech space.

FINTECHS IN THE US

Throughout 2020 and into 2021, previously non-bank financial technology companies of many business models (for purposes of this article, Fintechs) have made significant movement to obtain some form of banking license.

Many of these entities are licensed to engage in lending or money transmission on a state-by-state basis. While many Fintechs previously actively avoided "bank-like" regulation in the US, for various reasons, those same Fintechs are now actively seeking such status, notwithstanding the additional regulatory obligations. (For definitional purposes, a bank charter refers to a non-bank entity seeking a charter to engage in banking services at either the state or federal level, and a bank license refers to a non-US bank being licensed to open a branch or agency office to engage in wholesale banking services in the US at either the state or federal level).

WHY ARE FINTECHS SEEKING BANK CHARTERS/LICENSES?

There are almost as many types of bank charters/licenses as there are types of Fintechs seeking them. So they have publicly stated all sorts of reasons for doing so. However, certain themes predominate for Fintechs:

Easier regulation

- While the burden of bank regulation in the US is heavier than the regulatory burden of any one state, the burden is significantly less than that of 50 states (with separate licenses in almost every state for lending and money transmission)
- Federal bank charters preempt the need for state licenses. State bank charters may also limit the need for licenses from other states

Competition with other Fintechs and banks

- As the business models of Fintechs grow and mature, many find it difficult to offer consistent nationwide products when they must comply with 50 state laws
- As differences between Fintechs and banks converge, in order to meet banks where the opportunity lies, the Fintechs must also become banks

Greater access to government support

- Banks have certain advantages over Fintechs due to their status as banks, which include:
- Deposit insurance: the ability to fund at the lowest possible cost
- Liquidity support: the ability to access the Federal Reserve's Discount Window and to become a member of a Federal Home Loan Bank

WHAT TYPE OF CHARTERS AND LICENSES ARE FINTECHS SEEKING?

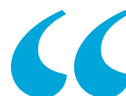
Many types of bank charters and licenses may apply to Fintechs in the US. Some of the most popular options for Fintechs, beyond a full bank charter, include:

State banking charters

- Industrial loan companies (ILC): Square and Nelnet each became an FDIC-insured, Utah-chartered ILC. ILCs engage in all manner of lending and can accept all insured deposits except consumer deposits. ILCs are not "banks" for purposes of the Bank Holding Company Act of 1956 (BHCA) and therefore, entities that own them are not bank holding companies (BHCs)
- Special purpose depository institutions (SPDI): Wyoming recently amended its banking laws to permit SPDIs. SPDIs are designed to be used primarily for banking digital assets such as cryptocurrencies. These entities are banks under Wyoming law, but not under the BHCA

State non-depository charters

- New York and other states' trust companies: These entities are



Many Fintechs that previously avoided bank-like regulation in the US are now actively seeking that status.

not banks under federal law, and their powers are largely limited to engaging in custodial and trust activities

Federal banking charters

- The Office of the Comptroller of the Currency (the OCC) has the authority to charter full national banks under the National Bank Act (NBA) where the parent companies will be BHCs
- The OCC has claimed the authority to de-couple the three core activities that make up a national bank under the NBA: lending, payments and accepting deposits. It is currently accepting applications for a "payments charter," which would be a full national bank that engages in payments (and perhaps lending) but does not accept insured deposits

Federal non-depository charters

- The OCC has the authority to charter federal trust companies, whose powers are similar to state trust companies. They also are eligible for certain perquisites available to national banks, such as preemption of many state banking laws

State/federal branch license

- Fintechs that are chartered as full-service banks in countries from which the Federal Reserve has approved entities to act as banks in the US may open branch or agency offices that can engage in full service commercial banking activities. They may be licensed on a state (often New York) or federal level. They are not authorized to engage in consumer banking in the US

What is the right charter/ license for a Fintech?

The answer to this question will vary based on the business model and plans of each Fintech:

- Fintechs whose business consists of consumer banking will likely need to apply for a full national bank charter
- For Fintechs engaged in payments activities with new blockchain technology, the best bet may be the OCC's payments charter
- For Fintechs engaged in the trading, settlement and custody of cryptocurrencies, a state- or federal-chartered trust company may allow the most flexible combination of powers and lighter regulation
- For Fintechs engaged in a wholesale or commercial banking business, an ILC may prove the best option
- For foreign banks interested in engaging in payments or cash management activities in the US, a state- or federal-licensed branch or agency may work well

FINTECHS IN THE UK

There is currently no separate regulatory structure or specific framework for Fintechs in the UK. Therefore, Fintechs must be authorized by the Financial Conduct Authority (FCA) or the Prudential Regulatory Authority (PRA) if they carry out any regulated activities within the scope of the Financial Services and Markets Act 2000. This means that Fintechs will be subject to the same rules and requirements as any other firm carrying out those activities.

The licenses for which a Fintech may need to apply include: permission to carry out claims management activities; consumer credit activities; benchmark-related regulated activities; designated investment business; issuance of e-money; insurance business and insurance distribution. Certain consumer credit activities only require "limited permission," although the required permissions are specific to each Fintech. The FCA's rules and its regulatory philosophy are intended to be technologically neutral, meaning that it is not committed to one technology or approach as the only way of working.

An application to the FCA (and to the PRA, if necessary) can take up to six months to complete (or 12 months if the application is deemed incomplete, or additional information is required). Although a limited permission is generally a short application process, with a lower application fee than a full permission application, the FCA will assess whether the applicant is "ready, willing and organized."[1]

Nevertheless, certain policies and initiatives have been implemented by both regulators to encourage innovation and Fintech development. A recent HM Treasury Report (The Kalifa Review of UK Fintech published on April 16, 2021) confirmed that both regulators need to ensure the regulatory approach to Fintechs "continues to not only protect consumers but also creates an enabling environment that encourages growth and competition."[2] Certain initiatives and policies to do so are considered below, and importantly, the FCA has committed (in a speech on April 20, 2021) to "better advertise the support we already offer those firms looking to build out their innovative offering."[3]

60+

organizations in the UK's GFIN

Regulatory sandbox

Since 2016, the FCA's regulatory sandbox has allowed businesses to test innovative propositions in the market, with real consumers. The sandbox allows businesses of all sizes to pilot the commercial and regulatory viability of innovative products and services in a live, but supervised, environment. Importantly, the regulatory sandbox is open to all types of financial services propositions, and successful applicants are submitted in "cohorts." The FCA will publish a description of the cohort for prospective applicants. For example, for the next cohort (cohort 7), the FCA has stated that they are particularly interested in products and services intended to detect and prevent fraud/scams, to support the financial resilience of vulnerable consumers and to improve access to finance for small- and medium-sized enterprises.

Applications to the regulatory sandbox are submitted via an application form, and for the last cohort, 22 businesses were accepted out of 68 applications. These included propositions that "make finance work for everyone" and "support the UK in the move to a greener economy."[4] For example, Mintago put forward an application for a "financial wellbeing platform provided by employers that gives their employees the education and

tools to plan their financial future."[5]

The Kalifa Review of UK Fintech suggested a number of enhancements to the regulatory sandbox. These include being available on a rolling basis (rather than through time-limited windows), offering support even where the proposal is not the first of a kind but is still providing or delivering an innovative proposition to the market, and creating a dedicated space in the regulatory sandbox for priority Fintech areas.

Importantly, Nikhil Rathi (the FCA's CEO) on April 20, 2021, confirmed that the FCA will soon begin allowing year-round applications for the regulatory sandbox.

Digital sandbox

The Kalifa Review of UK Fintech recommended that a permanent digital sandbox be created, in addition to the UK regulatory sandbox discussed above, to give participants access to a range of development tools (such as synthetic data assets for testing and developing proofs of concepts, an API marketplace, a coding environment, as well as access to expert mentors and observers). The digital sandbox is intended to allow innovative firms to test and develop concepts in a digital testing environment. Ninety-four organizations applied for the pilot, which ended in February 2021, and 28 businesses were selected to take part. The evaluation report confirmed that this greatly accelerated development times for most participants, and benefited the product design and refining of early stage business models. The FCA intends to launch a second phase of the digital sandbox later in the year.

"Scale box" for Fintechs

In addition to the digital sandbox, the Kalifa Review of UK Fintech recommended building upon the regulatory sandbox by implementing a "scale box" that would introduce certain measures to support partnering between incumbents and Fintechs and to provide additional support for regulated firms in their growth phase. In April 2021, Nikhil Rathi confirmed that the FCA would take steps to create this scale box, and commented that the plans were to "create a regulatory "nursery," which would create a period of enhanced oversight for newly authorized firms to develop their businesses. This will ensure that the FCA remains in close contact with Fintechs immediately post-authorization so that they can provide necessary support and, if required to intervene earlier, to steer firms in the right direction. Precise details of this scale box are still to be confirmed, but the underlying intention is that Fintechs will not be treated in exactly the same way as firms with a long regulatory track record.

Appointed representatives

Fintechs carrying out only certain regulated activities may choose to become "appointed representatives" rather than applying to the FCA to become fully authorized. This means that a principal (who must be FCA-authorized), rather than the Fintech, takes full responsibility for the carrying out of those regulatory activities. This is only permissible provided there is a contract between the Fintech and the authorized person that satisfies certain requirements. Fintechs that choose this path therefore do not need to become authorized in their own right, as they benefit

from the authorized status of their principal. Whereas applying to the FCA or PRA for authorization can be costly and take up to six months, becoming an appointed representative is typically a more straightforward process that can be completed in a matter of weeks, greatly speeding up the ability to commence operations. Although Fintechs that become appointed representatives need to comply with certain FCA rules, they do not need to comply with regulatory capital requirements, and the overall compliance costs are considerably less than if they were fully authorized by the FCA.

Importantly, however, an appointed representative can only carry out certain activities without requiring FCA authorization (such as safeguarding, arranging deals in investments and advising on investments). There are some regulated activities which will require Fintechs to become FCA-authorized in their own right.

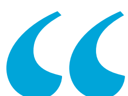
This is not an FCA initiative intended specifically to encourage Fintechs, but rather a mechanism that can help Fintechs operate in the UK without needing to obtain full authorization.

Direct Support

The FCA also tries to reduce the effects of the regulatory framework being a "barrier to entry" for Fintechs in the UK, through its "Direct Support" program. This provides a dedicated contact for innovative businesses that are considering applying for authorization that "need support when doing so, or do not need to be authorized but could benefit from our support."[6]

Fintechs wishing to apply for Direct Support must submit an information form to the FCA and provide basic information about their product or service and about their business generally. The FCA will then determine whether Fintechs are suitable for Direct Support. If so, they will assess the most appropriate level of support for the Fintech. Such support could include an explanation of the relevant parts of the UK regulatory regime, providing an "information steer" on potential regulatory implications at an early stage of business or product development, and giving informal individual guidance on specific issues.

The FCA may even provide specific assistance with submitting a license application, and Fintechs may receive ongoing support for up to one year after obtaining a license.



Some European digital banks have gained significant traction in regional and global markets and now attract millions of customers.

Global sandbox

To build on the FCA's regulatory sandbox, the Global Financial Innovation Network (GFIN) launched in January 2019 to help Fintechs (or innovative firms generally) interact in a more efficient way with regulators as they look to create new ideas.[7] This network of more than 60 organizations (including the FCA, the Central Bank of the UAE, the Federal Reserve Board and more) aims to help Fintechs navigate between countries as they look to scale new ideas. In the first round of applications under its Cross Border Testing (CBT) program, which closed in December 2020, applications could be submitted to 23 regulators in the US, the UK, the EU, Canada, the Middle East and Asia-Pacific using a single application form, which was then submitted to the desired regulators. It is likely too early to assess the tangible results of this program, but it could encourage Fintech development globally.

FINTECHS IN THE EU

Fintechs are by far the most successful startups in the EU in 2021 in terms of money invested in them.[8] The acceptance of Fintechs has increased across Europe, as they have grown in size, scale

and complexity. Some European digital banks have gained significant traction in regional and global markets and now attract millions of customers.[9]

Under what circumstances do Fintechs need a financial license?

Many Fintechs require a financial regulatory license under PSD2, MiFID2, CRD IV or Solvency II or specific member state laws to distribute their business models. In this context, the ECB issues various licenses for different banking activities. These include:[10]

- Traditional banking services (bank or specialized bank license)
- Payment processing and payment instrument issue (electronic money and payment institution license)
- Investment advice (investment advisory license) and securities brokerage (security broker license) services
- Investment fund distribution and management (investment funds management company license)
- Insurance, reinsurance (insurance company license) and insurance broker service (insurance broker license)

However, if a Fintech does not wish to apply for a license, it must limit itself to banking activities that do not require a license or outsource these activities to a company with a license.

Advantages and disadvantages of a license

The process of acquiring a license can take three months to a year and is resource-intensive. However, having your own license has significant advantages. The biggest advantage is the European passport, which allows Fintechs to offer their services throughout the EU, with some exceptions. This enables Fintechs to participate in a common market consisting of 27 states with 500 million customers and 21 million businesses. A banking license can also lead to Fintechs gaining wider recognition and legitimacy. Above all, this can help break down barriers and mistrust and increase a Fintech's reputation in the broad financial landscape. In addition, a banking license can open up a new range of banking products. This can be a big step, especially in terms of marketing or brand perception. In summary, a banking license can provide the following benefits:

- Broader scale and larger customer base, especially in retail
- Passporting benefits throughout the EU's single market
- Gain retail depositors' trust via deposit guarantee schemes
- Long-term efficient capital base
- Validation of business model
- Competitive advantage in the increasingly crowded Fintech startup space
- Preparation for new opportunities and a level playing field for PSD2

At the same time, disadvantages associated with a license include the need to comply with regulatory requirements such as specific organizational design, risk management, staffing, capital and reporting requirements, AML and others.

Types of cryptocurrency registration

Currently, a uniform European regulation and licensing requirement for the commercial handling of cryptocurrencies is not clearly regulated by law,[11] although a proposal exists for the Markets in Crypto Assets Regulation (MiCAR). It would classify some cryptocurrencies as "significant," thus requiring supervision and approval by the ECB, while others would only have to submit to the national supervisory authority. In some of these EU member states, regulations have already been issued.

In Germany, for example, the Federal Financial Supervisory Authority (BaFin) is responsible for supervising crypto custody businesses. This primarily includes companies entrusted with the safekeeping of crypto assets for their customers, who are thus required to have a license. Furthermore, cryptocurrencies are also generally considered "financial instruments," which means their commercial use is subject to licensing under fiat standards.

Other countries that have enacted regulations include Lithuania, which distinguishes between cryptocurrency exchanges and cryptocurrency wallet management in its licenses, and Malta, which distributes its licenses according to four classes, each of which provides stronger regulations for broader uses of cryptocurrencies.

White label banking

Instead of having its own license, a Fintech can also "borrow" the required license by using the banking license of an authorized service provider (a white label bank). This service provider then provides services under the name of the Fintech company. With the support of the white label bank, the Fintech can concentrate on its core business and, above all, save itself capital-binding investments. Further advantages include developing a brand, a short time-to-market phase and benefiting from the service provider's knowledge. However, white label banking also creates some disadvantages. A brand's credibility brand can be lost, and it makes the Fintech highly dependent on the financial services institution.[12]

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Regulatory Hot Topics: Highlights

It has been a period rife with notable shifts on the global stage; a new administration in the US, the end of the Brexit transition period and the reaching of key milestones in the discontinuation of LIBOR, to name but a few. This section provides an overview of recent developments in some key regulatory hot topics.

By Dr. Henning Berger, Jonathan Rogers, Julia Smithers Excell, Duane Wall, Roseann Cook and Samantha Richardson

ESG AND REGULATING SUSTAINABLE FINANCE

In the financial markets, ESG is undoubtedly a hot topic and momentum, in respect of both the creation and acceptance of ESG-linked financial products, continues unabated. The question of how to regulate the transition to a carbon-neutral economy, however, is one that is yet to be answered unequivocally. Below we detail recent developments in this area in each of the United States, Europe and the United Kingdom.

UNITED STATES

The US banking regulators are considering ways to integrate climate risk and other ESG considerations into the supervisory framework for the banks they supervise, including:

- Potential implementation of mandatory climate risk stress tests by the Federal Reserve Board for large banks and large nonbank financial service providers that could require legislative action by Congress and would need to address concerns related to test subjectivity, remediation variability and sharp differences among covered-firm business models that are seen as potentially undermining the goals of stress testing and creating regulatory-arbitrage opportunities
- The OCC decision not to implement its so-called "fair access" rule, which would have required banks to ensure fair access to financial services, credit and capital for all customers, including fossil fuel companies and other corporate borrowers on the basis of climate risk or other ESG-related considerations
- The DOL decision not to enforce the so-called ESG rule issued at the end of the Trump Administration, which would have prohibited ERISA plan managers from making investment decisions based on non-pecuniary considerations, such as climate risk
- The Federal Reserve Board's reported consideration of the needed bank climate risk management policies, including privately asking member banks to detail the steps they are taking to mitigate the potential climate-related financial risks of their loan portfolios, such as by conducting risk management exercises to identify and provide the regulators with data on the geographical exposure of bank assets to physical risks, such as floods and wildfires and tests on bank exposures to particular sectors, such as oil and gas

EUROPEAN UNION

The Commission has established an EU framework that puts ESG considerations at the heart of the financial system to help transform Europe's economy into a greener, more resilient and circular system.

On July 6, 2021, the European Commission published a new strategy for financing the transition to a sustainable economy. This strategy builds on the 2018 action plan on financing sustainable growth, recognizes the need for an updated approach given that global cooperation on sustainable finance has increased and the international context has evolved. The strategy identifies four main areas where additional actions are deemed necessary for the financial system to support sustainability (transition finance, inclusiveness, resilience and contribution of the financial sector and global

ambition) and includes the following six actions:

1. Improve access to transition finance by extending the existing sustainable finance toolbox
2. Improve inclusiveness by giving SMEs and consumers the necessary tools and incentives to access transition finance
3. Enhance the resilience of the economic and financial system to sustainability risks
4. Increase the contribution of the financial sector to sustainability
5. Ensure the integrity of the EU financial system and monitor its orderly transition to sustainability
6. Develop international sustainable finance initiatives and standards, and support EU partner countries

The Commission will report on the implementation of the strategy by the end of 2023.

On the same day, the Commission also proposed a Regulation to create the "European Green Bond Standard," a voluntary "gold standard" for green bonds, the use of which will facilitate the raising of large-scale financings for climate and environmentally friendly investments, while protecting investors from greenwashing.

UNITED KINGDOM

The FCA recently published two consultation papers to enhance climate-related disclosures; the first, CP21/17, relates to disclosures by asset managers, life insurers and FCA-regulated pension providers, and the second, CP21/18, relates to disclosures by standard listed companies. Both consultations closed on September 10, 2021 and the FCA is expected to publish a policy statement containing final rules later in 2021.

CP 21/17

CP 21/17 sets out proposals to introduce climate-related financial disclosure rules and guidance consistent with the TCFD's recommendations and recommended disclosures. Furthermore, the FCA is introducing a new "Environmental, Social and Governance Sourcebook" in the FCA Handbook, where the proposed rules and guidance will be set out. The key elements of the proposals are:

- **Entity-level disclosures**—On an annual basis, firms would be required to publish an entity-level TCFD report on how they take climate-related risks and opportunities into account in managing or administering investments on behalf of clients and consumers. These disclosures must be made in a prominent place on the main website for the firm's business, and would cover the entity-level approach to all assets managed by the UK firm
- **Product or portfolio-level disclosures**—Firms would be required to produce an annual baseline set of consistent, comparable disclosures in respect of their products and portfolios, including a core set of metrics. Depending on the type of firm and/or product, these disclosures would either be in a TCFD product report made available on the firm's website or be made upon request to certain institutional clients

CP 21/18

In CP21/18, the FCA is extending the application of the disclosure requirements for premium listed companies (which were set out in PS20/17) to issuers of standard listed equity shares. These proposals would require such issuers to include a statement in their annual financial report detailing:

- Whether they have made disclosures consistent with the TCFD's recommendations and recommended disclosures in their annual financial report
- Where they have not made disclosures consistent with some or all of the TCFD's recommendations and/or recommended disclosures, an explanation of why, and a description of any steps they are taking or plan to take to be able to make consistent disclosures in the future and the timeframe within which they expect to be able to make those disclosures
- Where they have included some, or all, of their disclosures against the TCFD's recommendations and/or recommended disclosures in a document other than their annual financial report, an explanation of why
- Where in their annual financial report the various disclosures can be found

In an effort to generate discussion and engage stakeholders in respect of sustainable debt instruments and ESG data and rating providers, the consultation paper also includes a discussion component on various ESG topics.

Separately to the above consultation papers, the UK Government has committed to implement a UK taxonomy, taking the scientific metrics in the EU taxonomy as its basis. On June 9, 2021, a new independent expert group, called the Green Technical Advisory Group (GTAG), was established to advise on standards for green investment. GTAG will provide independent, non-binding advice to the Government on developing and implementing a green taxonomy in the UK context. GTAG is expected to provide its initial recommendations to the Government in September 2021.

CHANGING POLITICAL LANDSCAPE

Of late, the global political stage has been subject to considerable levels of drama. In the US, there has been a change in administration and President Biden's 100-day speech gave insight into the big-ticket items on his agenda, which include addressing climate change, investing in infrastructure, expanding healthcare coverage and reforming immigration laws. The big question for financial services is to what extent the regulatory agenda will change and how much of the Trump Administration's tailoring of prudential regulatory requirements will be undone. On the other side of the pond, the evolution of the post-Brexit regulatory landscape garners considerable attention as we continue to monitor the extent to which the UK will diverge from the EU and consider the impact of the divergence.

UNITED STATES

While banking regulation has not been high on the regulatory agenda, the Biden Administration has proposed a number of regulatory initiatives that are focused on Fintechs, cryptocurrencies and the extent to which activities related to each should be regulated, including:

- A Congressional resolution signed by President Biden in June that formally invalidated the "true lender" rule implemented by the OCC under the Trump Administration in an effort to create a single simple test to allow a bank loan acquired by a Fintech to continue to benefit from preemption of state usury laws and draws into question the "valid when made" rule also implemented by the OCC to establish that the interest permissible before a loan transfer from a bank to a Fintech continues to be permissible after the transfer at rates that may exceed state usury laws
- Indications from the Biden appointee for SEC Chair Gary Gensler that the SEC is likely to actively regulate crypto trading and lending platforms and stablecoins and to treat cryptocurrency as both a commodity and a security
- Guidance from the OCC clarifying that banks may use stablecoins in payments, custody and other activities and offering leeway for banks to issue stablecoins
- An executive order signed by President Biden on July 7 that requires the CFPB to establish open banking and a more open banking ecosystem that facilitates data sharing across platforms by giving consumers access to their bank data and the ability to transfer data between banks and banking apps

EUROPEAN UNION/UNITED KINGDOM

The UK's departure from the EU has created new uncertainties in EU-UK cross-border financial services. One such area is the regulatory landscape that EU and UK financial services firms will have to navigate when doing business in the EU and the UK. As an automatic consequence of the UK's departure from the single market, passporting rights to and from the UK ended, and the lack of provisions in the Withdrawal Agreement and the EU-UK Trade and Cooperation Agreement has left financial services providers with little guidance on the long-term cross-border regulatory framework. In March 2021, the UK and the EU agreed on the text of a memorandum of understanding establishing the framework for this cooperation, but this has not yet been ratified.

In preparation for the end of the transition period, the UK and the EU adopted various, often temporary, equivalence determinations in respect of each other. Full details of these are contained in our Equivalence Tracker, available on our Equivalence Microsite.

EU and UK policies have largely remained aligned to date, but each side is now able to pursue their own regulatory agenda and market participants may soon be forced to deal with more pronounced regulatory divergence.

LIBOR AND THE TRANSITION TO RFRS

The London Interbank Offered Rate, more commonly known as LIBOR, is one of the most significant global benchmarks for calculating interest and underpins much of the global financial system. Yet in 2017, the Financial Conduct Authority (FCA) called for LIBOR to be phased out by 2021 and replaced by alternative, risk-free rates. LIBOR's discontinuation is considered one of the biggest challenges to ever affect the global financial markets and market participants need to keep up with the ensuing changes, including the regulatory complexities. Below we set out recent developments in the transition to alternative rates since the beginning of 2021.

UNITED STATES

While USD LIBOR will be available until June 30, 2023, US financial regulators have imposed a hard deadline of December 31, 2021, on the cessation of the origination of LIBOR-referenced contracts and are pressing market participants to ensure speedy progress toward a post-LIBOR financial system. The Financial Stability Oversight Council (FSOC), which comprises the US federal financial regulators, expressed concern at its June meeting that loans tied to LIBOR continued to grow and emphasized that "deniers and laggards" not moving swiftly enough to replace the benchmark will not be tolerated. While market participants and the regulators continue to question the efficacy of SOFR as the alternative to USD LIBOR, considerable progress has been made in its adoption, including:

- ARRC's formal recommendation of the CME's forward-looking SOFR term rate, following the July 26 adoption of "SOFR First" best practices to be used in switching interdealer trading conventions to SOFR for USD linear rate swaps
- ARRC adoption of best practices and conventions for the use of forward-looking SOFR for all products
- The implementation of legislation in New York to address the conversion of "tough" legacy contracts from LIBOR
- The issuance of guidance by US banking regulators on the continued regulatory capital eligibility of LIBOR-based instruments

EUROPEAN UNION

Although there is currently no plan to discontinue EURIBOR, on May 11, 2021, the Working Group on Euro Risk-Free Rates published recommendations on EURIBOR fallbacks, covering events that could trigger fallbacks in EURIBOR-linked contracts and the rates that could be used if a fallback is triggered. The recommendations include an €STR-based EURIBOR fallback rate for specific use cases, including corporate lending, debt securities, securitizations and trade finance, as well as recommendations for a spread adjustment to be added to the fallback rate.

The Working Group on Euro Risk-Free Rates felt that it was necessary to develop more robust fallback language in order to address the risk of a potential permanent discontinuation, to enhance legal certainty and bring it in line with the EU Benchmarks Regulation.

UNITED KINGDOM

The market continues to work towards the Sterling Working Group's roadmap so that, by the end of 2021, the market will be fully prepared for the end of GBP LIBOR. At the end of Q3, we will have passed the next milestone in the roadmap, which requires active conversion of all legacy GBP LIBOR contracts that expire after the end of 2021 where viable and, if not viable, ensure robust fallbacks are adopted where possible.

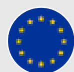
On September 8, HMT introduced to Parliament the Critical Benchmarks (References and Administrators' Liability) Bill (the Bill), an important piece in the UK's "safe harbour" legislation for the transition away from LIBOR. The Bill aims to provide certainty that contractual references to LIBOR will continue to be treated as references to that benchmark where the FCA has directed a change in how it is calculated; *i.e.*, synthetic LIBOR. The Bill also aims to prevent the operation of fallback clauses that are triggered on the cessation (or unavailability) of the relevant benchmark where the FCA continues to publish that benchmark under a revised methodology. The Bill also provides, however, that where a contract or other arrangement includes a fallback clause to operate by reference to something other than the benchmark in question, the operation of that fallback clause is not affected. The intention is to not override contracts that provide for alternative arrangements to be triggered either before or during LIBOR's wind-down. In addition, the Bill aims to provide certainty to parties that, unless their contract provides otherwise, the designation of a benchmark under the Benchmarks Regulation, and any subsequent changes to that benchmark imposed by the FCA, are not in themselves grounds for termination of the relevant contract.

PRUDENTIAL REGULATION

Even in a healthy, competitive market, some firms may and do fail, and so it is to be expected that both during and following a prolonged global pandemic with numerous lockdowns, the regulators will be closely monitoring the outlook for firms. The regulator's role, however, is not to prevent firms from failing but to minimize detrimental spillover for customers, counterparties and market stability, and mitigate the impact of failure. Below we consider some recent developments in the area of prudential regulation.

UNITED STATES

While the banking regulators continue to express overall satisfaction at the level of prudential regulation in protecting the resilience of systemically important banks, the Treasury Department increased its scrutiny of technology companies that are key to the financial system and considered too-big-to-fail, including to investigate the growing dependence of banks on these technology providers, who risk "locking" them in.



EUROPEAN UNION

The final Basel III standards are a package of reforms that were mostly agreed by the Basel Committee on Banking Supervision (BCBS) in December 2017. The BCBS' implementation date for most of these reforms is January 1, 2023 (postponed from an original date of January 1, 2022, as a result of the COVID-19 pandemic).

In September 2021, the EBA and the ECB sent a joint letter to the Commission calling on it to implement the final Basel III standards "in a full, timely and faithful manner" and the Commission is widely expected to adopt a legislative package to implement the final Basel III standards in October 2021.

UNITED KINGDOM

The UK Investment Firm Prudential Regime (IFPR) is a new streamlined and simplified regime for the prudential regulation of investment firms in the UK. The IFPR is being introduced by the FCA in accordance with the new Financial Services Bill and new Part 9C of the Financial Services and Markets Act 2000. The IFPR is heavily based on the EU Investment Firms Regulation ((EU) 2019/2033) (IFR) and the Investment Firms Directive ((EU) 2019/2034) (IFD), which HMT and the FCA are adapting for the prudential regulation of FCA-regulated investment firms.

The intention behind the new proposal is to create a new prudential regime tailored specifically for investment firms that better aligns the standards and rules which apply with the business model of this type of firm (as well as the possible sources of possible harm). The key changes involve:

- New liquidity rules for UK investment firms
- Changes to the level of initial capital to be held, which will increase for most firms
- A brand new approach to calculating capital known as the "K factor" approach
- New rules on remuneration and disclosure, which allow less scope for firms to determine their approach based upon proportionality principles

The FCA has published three consultation papers on the new regime, the last of which closed for responses on September 17, 2021 and the new rules are expected to come into effect in January 2022, subject to HMT making the necessary secondary legislation under the Financial Services Act.

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