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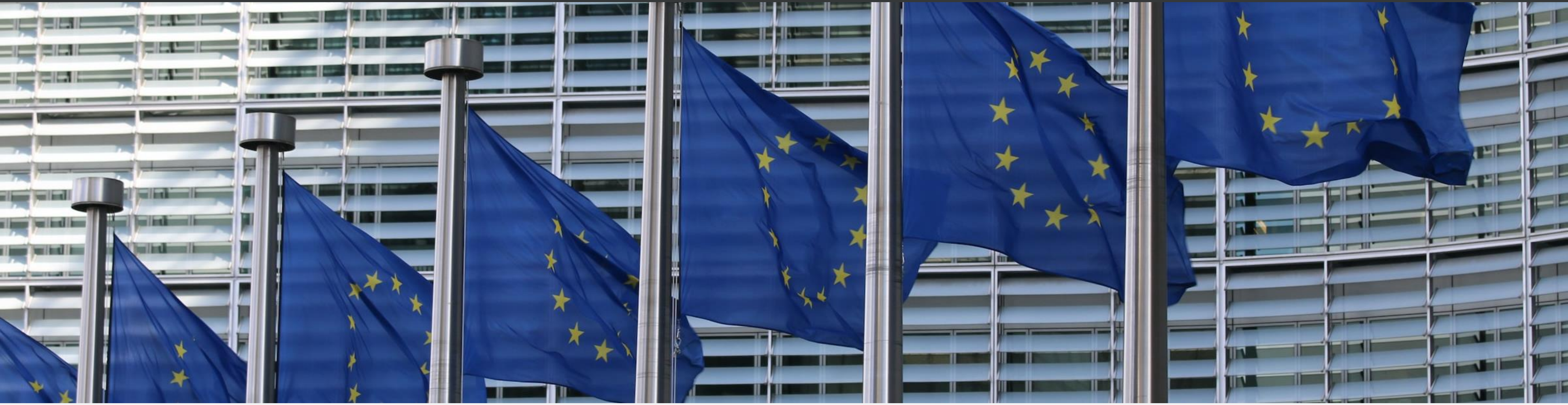

An Update On EU Financial Services Legislation - A View From Brussels

Dr David Doyle, Board, Kangaroo Group (EU Parliament), EU Policy Director, The Genesis Initiative

Monday, 09 January 2023

A Word From Today's Chairman

Charlotte Dawber-Ashley

Manager, FS Club

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Today's Agenda

- 15:00 – 15:05 Chairman's Introduction
- 15:05 – 15:25 Keynote Presentation – Dr David Doyle
- 15:25 – 15:45 Question & Answer

Today’s Speaker

Dr David Doyle

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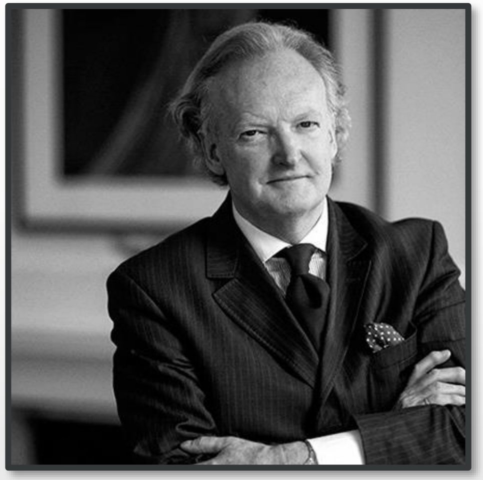

Key EU regulatory agenda priorities

Large investment firms.
New licence, new supervisor (ECB), focus on entities with bank-type activities, i.e., credit and market risk, dealing on own account, underwrites/places financial securities on commitment basis.

EU digital strategy.
Crypto assets regulation covering providers/issuers, subject to capital endowment, governance rules.

Sustainability risks disclosure regime.
Report on how sustainability risks of own investments in economic activities are managed + impact on environment and people. Report on ESD impact of products offered to clients.

New EU anti-money laundering authority.
Direct supervisory powers over the 40 'riskiest' financial sector firms with cross-border operations.

Revised AIFMD, MiFID and UCITS regimes.
Aligning disclosure requirements covering trading activities and retail investor protection.

EC strategic autonomy — reducing 'over-reliance' on non-EU financial institutions.
Strengthening EU derivatives' clearing CCPs, reducing risk via dollar-denominated transactions, exposure to foreign exchange swap markets.

The future of Third-Country Bank Branches in Europe – a new foreign bank regime

- EC integrates provisions on 3rd country banks (TCBs) into Basel III (CRD6/CRR3): authorization, capital, liquidity, governance, reporting & supervision.
- All TCBs subject to a (re) authorization requirement, including NCA '<u>national option</u>' to impose more stringent market access rules
- TCBs categorized as:

Class 1: assets booked by the TCB in the MS is equal to/above €5bn, or

- TCB takes deposits & other repayable funds from retail customers
- TCB is not a 'qualifying TCB

Class 2: assets <u>below</u> €5bn, not taking retail deposits

- **For systemic TCBs**, i.e., assets in excess of €40bn, several NCA tools can be deployed:
  - Requirement to subsidiarize (NCA option only)
  - Requirement to restructure assets/liabilities so that it ceases to be systemic;
- **Capital endowment rules**
  - Class I: 4% of branch's average liabilities
  - Class 2: 1% of the branch's average liabilities

Liquidity rules:

- TCBs to deposit liquid assets to escrow account as security for resolution purposes

Core focus of Brussels' negotiations : what 'core banking services' require a 3rd-country branch?

- ❑ Reinforcement of Art 21 requiring 3rd country banks to establish a branch and apply for an authorization to provide 'core banking services' in a single Member State …especially services dealing with **retail clients**
- ❑ Scope for mandatory 3rd country branch establishment limited to the following activities:
- ❑ Rules also applies to systematic and large investment firms

Exemptions

- ❑ Reverse solicitation when contracting with all client categories, including retail clients – at *client own exclusive initiative*
- ❑ MiFID ancillary services under MiFID excluded

- ✓ Taking deposits and other repayable funds.
- ✓ Lending including, inter alia: consumer credit, credit agreements relating to immovable property, factoring, with or without recourse, financing of commercial transactions, financial leasing.
- ✓ **Lending to EU corporations only possible via a TCB or a subsidiary in the EU, and not directly from 3rd country bank based in a 3rd country .**
- ✓ Payment services, and issuing and administering other means of payment: i.e., travelers' cheques and bankers' drafts
- ✓ Guarantees and commitments
- ✓ Credit reference services
- ✓ Safe custody services
- ✓ Issuing electronic money.

Source: Annex I of Directive 2013/36/EU

Visibly more powers for NCA's under new TCB regime!

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- NCA granted powers to ascertain if TCBs are of systematic importance: financial stability risk:

  - Aggregate amount of assets in excess of €40bn held by single TCB or series of TCBs in 27EU

  - Level of intra-group services provided to remainder of the Group: interconnected activities with subsidiaries /branches

- Role of NCA's in applying stricter rules on TCBs

  i.e., higher prudential standards, imposing subsidiarisation if TCB :

  - breaches EU rules
  - is **systemic**
  - poses significant risks to EU State of establishment
  - poses risks to EU financial stability

NCA assessment criteria of 'systemic'' TSB:

- Size of the TSB
- Type of business conducted by TSB
- Degree of interconnectedness vis-à-vis local financial system
- Substitutability of the activities, services or operations
- Market share
- Likely impact that a suspension/closure of TSB on clearing, settlement, payments systems of country of establishment

New EU AML Authority...scaling-up EU-wide supervision and oversight of high-risk financial entities, by 2025

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Creation of new EU anti-money laundering authority

- Oversight powers over 40 most high-risk financial entities
- Extending AML monitoring to the private sector, and embrace crypto-asset service providers and crowd-funding platforms
- Introduces measures for 3rd-countries whose AML/CFT policies pose a risk to EU financial stability to the EU
- Streamlined Beneficial Ownership requirements and measures to combat misuse of bearer instruments

European Commission

Categories of obliged entities to be monitored/supervised:

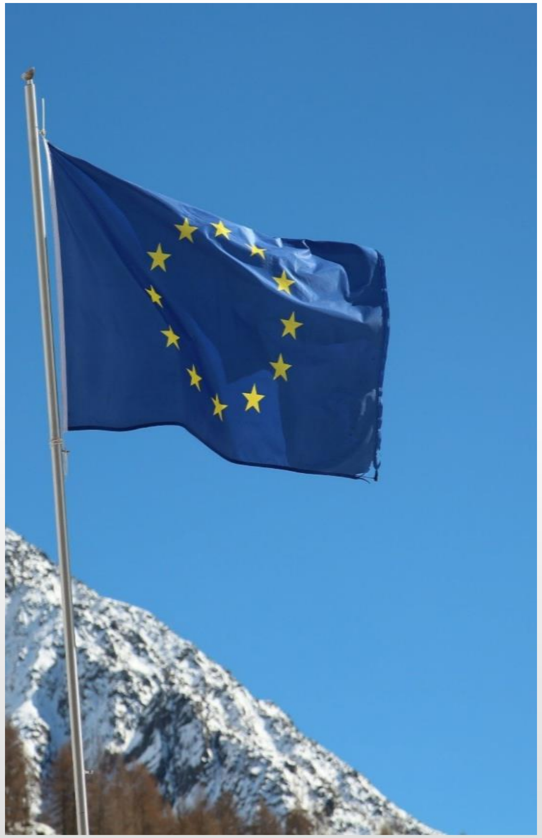
- credit institutions
- bureaux de change
- collective investment undertakings
- credit providers other than credit institutions;
- e-money institutions
- investment firms
- payments service providers
- life insurance undertakings
- life insurance intermediaries
- crypto-asset service providers

Three categories for specific attention:

- high-risk cross-border credit and financial institutions with activity in a significant number of Member States, selected periodically
- in exceptional cases, any entity whose serious, systematic or repeated breaches of applicable requirements are not sufficiently or in a timely manner addressed by its national supervisor.
- directly supervise at least one entity in each Member State.

Amended UCITs and AIFMD regimes…retaining the 'Delegation Model', with more disclosures to national regulators

- ❑ Continuity of delegation of portfolio management/risk to 3rd countries, but more prescriptive disclosures required to NCAs:
  - List & description of delegated functions/activities
  - Information about delegates and AIFM/UCITM due diligence over delegates, performance, sub-delegation,
  - Amount é percentage of assets delegated on portfolio management
- ❑ Management companies required to hire minimum of 2 persons on full-time basis and be resident in the EU
- ❑ Strengthen NCA powers to 'authorise' and supervise 3rd-country delegation plans
- ❑ Alignment of delegation rules between (more detailed) AIFMD and UCITS – avoiding 'letter-box entities' - goes beyond delegated portfolio & risk management tasks
- ❑ Non-accredited AIFMs cannot sub-delegate functions delegated to them by the AIFM
- ❑ No EU depository passport per se, but limited EU cross-border depository framework in concentrated markets with few providers

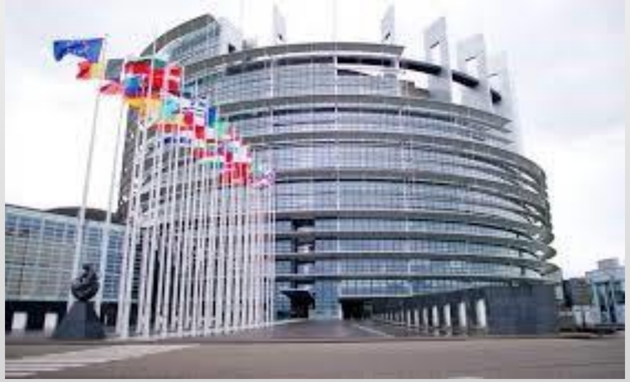


Markets in Crypto-Assets Regulation - EU taking the lead but weak transnational coordination

- Comprehensive MICA regulatory framework for ALL crypto-assets and service providers:
  - **Issuers** of unbacked crypto-assets and stablecoins
  - **Service Providers** (CASP): exchanges, trading platforms, custodian wallet providers
  - Key focus: investor protection and financial stability
  - MICA broad definition vis-à-vis other non-EU regions: trading, advice, transmitting orders, custody, crypto-to-crypto, crypto-to-fiat exchange
  - MICA imposes liability on CASPs for custody losses, i.e., cyber attacks on digital wallets
  - Robust anti-money laundering dimension: due diligence on transfer of funds (Transfer Rule)
  - No EU Equivalence nor Mutual Recognition likely for non-EU crypto-asset actors
  - Split NCA + EBA supervisory oversights for CASPs and issuers

SCOPE

- **Asset-referenced Token (ART), i.e., Libra Basket Coin – backed by basket of currencies to facilitate global payments**
- **E-Money Token (EMT), i.e., dollar-based USDC/USDT,**
- **Utility Token, i.e., Filecoin, Basic Attention Coin – digital access to goods and services – only accepted by the Issuer of that token**
- **NFTs out-of-scope, but now include fractionalized NFTs. Wider NFT regime justification to be review end by EBA**
- **Algorithmic Stablecoins now in the scope**
- **MiFID instuments excluded**



Markets in Crypto-Assets Regulation - no cross-border activities allowed without EU approval

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Rules for Issuers (other than stablecoins)

- Must establish a legal entity in the EU
- Apply for authorisation (White Paper) 20 days prior to emission to national regulator. Compliance with rules on marketing communications, prevent conflicts of interest and maintain IT systems and security protocols matching EU level of requirement.
- For ARTs : only available via EU authorised entity, direct authorisation by EBA + College of NCA's, and prudential requirements apply
- E-money Tokens: only available via EU authorised banks or e-money institutions
- Different approach for crypto-currencies:
  - Digital currencies can only be issued by a bank or Fintech company plus authorised licence to sell such products
  - Issuers of stablecoins subject to minimum level of reserves, liquidity rules, and an EU presence

Rules for Providers

- Service-providers of crypto-assets require prior approval by NCA's for range of activities: custody, brokerage, trading, investment advice.
- Need to be authorised in the EU, 'EU Passport' possible
- Requirements: prudential, safekeeping of clients cryptoassets and funds, assertive level of liability for custody, outsourcing rules

European Commission

Markets in Crypto-Assets Regulation – the prudential regime and EU supervision

Issuers

- Issuers to own and maintain capital funds: €350,000 or 2% of their total reserve assets – whichever is largest
- Significant' Issuers: market capitalisation in excess of at least €1bn and records 500,000 transactions per day: maintenance of capital funds equal to 3% of reserve assets, i.e., USDC/USDT
- Issuers of stablecoins: subject to capital & liquidity rules, with 1/ ratio, partly in form of deposits, and mandatory EU presence

Supervision

- **ARTs supervised by EBA + College of NCAs**
- **E-money tokens supervised by NCAs**
- **Significant e-money tokens supervised by dual NCAs/EBA + College of Supervisors**
- Stablecoin issuers supervised by the EBA

Providers

- Initial capital reserves
- Security of the IT infrastructure
- Solid corporate governance structure

Supervision

- CASPs supervised by NCA's who enforce requirements under MICA
- CASP's with in excess of 15m active users classified at 'significant' CASPs' remain supervised by NCAs, but ESMA to have 'intervention powers' to ban or restrict provision of crypto-assets services: risks of investor protection, market integrity, financial stability
- CASPs to be directly supervised on compliance with AML rules by new EU AML Authority (2025): 'obliged entities' for AML/CFT purposes.

Comments, Questions & Answers

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- Wed, 11 Jan (11:00-11:45) China's Worlds: What Does Xi Jinping Want For His Country
- Thu, 12 Jan (11:00-11:45) The Curious Economics Of Authenticity
- Tue, 17 Jan (11:00-11:45) Alchemy: The Surprising Power Of Ideas That Don't Make Sense

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