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16 March 2022

Financial Regulation Monthly Breakfast Seminar

Overview

- Sanctions – an update
- Commentary from the FCA in light of Russian sanctions: MAR and cryptoassets
- PRA operational resilience
- HM Treasury's Wholesale Markets Review Consultation Response: the approach ahead
- Sustainable Finance Roadmap 2022-2024: highlights on what ESMA sees ahead

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Sanctions – an update

Charles Claypoole

The new sanctions regimes imposed on Russia

- The main regimes that have implemented sanctions on Russia following recent events in Ukraine:
    - The United States
    - The European Union
        - Followed in Switzerland and European Economic Area countries
    - The United Kingdom
        - Applied in offshore territories, e.g., British Overseas Territories and Crown Dependencies
    - Canada
    - Japan
- Also need to consider measures put in place by other countries (e.g., South Korea and Singapore) and potential impact of Russian countermeasures

The pre-existing situation: the United States

- Embargo on trade with Crimea
- OFAC designations on the List of Specially Designated Nationals (SDNs)
  - Russian and Ukrainian political and military individuals and entities
  - Russian businesspersons (“oligarchs”), including Oleg Deripaska and Viktor Vekselberg
  - Any entity that is owned 50% or more by one or more SDNs is treated as an SDN “by operation of law”
- Sectoral sanctions targeting specific sectors of the Russian economy
  - Directive 1 (Financial Firms, e.g., Gazprombank, Sberbank, VTB Bank, VEB)
  - Directive 2 (Energy Firms, e.g., Gazpromneft, Rosneft)
  - Directive 3 (Defence Firms)
  - Directive 4 (Energy Firms)
- CAATSA (2017) enhanced existing U.S. sanctions, and provided for secondary sanctions that may be imposed on non-U.S. persons engaging in certain activities related to Russia

The pre-existing situation: the EU and the UK

- Prohibition / restrictions on certain trade with and investment in Crimea
- Asset freeze sanctions imposed on designated individuals and entities
  - Regime 1: misappropriation of Ukrainian state funds and human rights violations
  - Regime 2: undermining the territorial integrity, sovereignty and independence of Ukraine
  - Presumptively apply to any entity that is majority owned or controlled by a designated person
- Prohibitions on dealing with transferable securities / money-market instruments (with certain maturities) or extending credit to:
  - Listed State-owed banks (e.g., Gazprombank, Sberbank, VTB Bank, VEB)
  - Listed energy companies (e.g., Gazpromneft, Rosneft)
  - Listed defence companies
  - Non-EU (UK) subsidiaries and entities acting on behalf of at the direction of such entities
- Export restrictions (dual-use goods, listed goods and services for the Russian oil industry)

The current situation: new U.S. financial sanctions

- Significant further OFAC designations on the SDN List
  - VEB, Promsvyazbank, VTB Bank, Bank Otkritie, Sovcombank (and named subsidiaries)
  - Nordstream 2 AG
  - RDIF
  - NB permitted time-limited activities under General Licenses
- Prohibition on U.S. financial institutions having correspondent accounts with Sberbank and its foreign financial institution subsidiaries
- Restrictions on dealings with Russia's sovereign debt (e.g., bonds issued by Russian Central Bank, National Wealth Fund and Ministry of Finance)
- Prohibitions on dealings with new debt / equity issued by listed Russia state-owned enterprises and their subsidiaries, including
  - Gazprom, Rostelecom, Sovcomflot, Russian Railways, Alfabank

The current situation: new U.S. trade sanctions

- Embargo on trade with Crimea extended to the so-called Donetsk and Luhansk People's Republics
- New export restrictions:
  - New license requirement for exports / re-exports of goods subject to the EAR classified under certain ECCNs, with a presumption of denial
  - Expanded military end-use controls
  - On export and re-export of luxury goods
  - On transfer of US dollar-denominated banknotes to Russia
- New import prohibitions:
  - Russian crude oil, petroleum, petroleum fuels, oils, liquefied natural gas, coal, and coal products
  - Certain Russian-origin food products and non-industrial diamonds
- Prohibition on "new investment" in the Russian energy sector

The current situation: new EU financial sanctions

- Further designations to the EU asset-freeze list
  - President Putin, Foreign Minister Lavrov, various Russian government ministers, members of the Duma
  - Bank Rossiya, Promsvyazbank and VEB (with limited derogations)
- Prohibition on participation in projects co-financed by RDIF
- Prohibition on the provision of “public financing or financial assistance” for trade with or investment in Russia
- Prohibition on dealing with transferable securities / money-market instruments (with stated maturities), or extending (long-term) credit to, further entities, including:
  - The Russian Government and the Central Bank of Russia
  - Alfa Bank, Bank Otkritie, Bank Rossiya and Promsvyazbank
- Prohibition on listing or providing services on EU trading venues for publicly owned Russian entities

The current situation: new EU financial sanctions

- Further prohibitions on:
  - Accepting deposits from Russian nationals, residents or legal entities (unless EU nationals or residents) if the total value of deposits per credit institution exceeds EUR 100,000
    - Subject to applicable rules on confidentiality, credit institutions must provide a list of Russian nationals, residents or legal entities with deposits of more than EUR 100,000 to the relevant national competent authority by 27 May 2022 and provide yearly updates
  - EU central securities depositories from providing services for securities issued after 12 April 2022 to Russian nationals, residents or legal entities (unless EU nationals or residents)
  - Selling Euro-denominated transferable securities issued after 12 April 2022 or units in related collective investment undertakings to Russian nationals, residents or legal entities (unless EU nationals or residents)
  - Transactions related to the management of reserves or assets of the Central Bank of Russia
  - The export of Euro-denominated banknotes to or for use in Russia
  - Providing specialised financial messaging services (SWIFT) to:
    - Bank Otkritie, Novikombank, Promsvyazbank, Bank Rossiya, Sovcombank, VEB, VTB Bank

The current situation: new EU trade sanctions

- Prohibitions on certain trade with and investment in the non-government controlled areas in Donetsk and Luhansk
- Prohibitions / restrictions on the export to or for use in Russia of:
    - Dual-use goods
    - Goods and technology which might contribute to Russia's military and technology enhancement
    - Goods for use in oil refining
    - Goods and technology for use in the aviation and space industries

The current situation: new UK financial sanctions

- Further designations to the UK asset-freeze list
  - President Putin, Foreign Minister Lavrov, various Russian government ministers, members of the Duma
  - IS Bank, Rossiya Bank, Promsvyazbank, Genbank, VTB Bank, VEB, Bank Otkritie, Sovcombank (with limited exceptions and scope for derogation, and permitted time-restricted activities under General Licences)
- Prohibition on dealing with transferable securities / money-market instruments (with certain maturities) or granting certain categories of loans to further entities, including:
  - UK subsidiaries of the financial institutions, State-owned energy companies and defence companies previously subject to financing restrictions
  - Persons "connected with Russia" - subject to certain exceptions
  - The Government of Russia (as defined)

The current situation: new UK financial sanctions

- Further prohibitions on:
  - UK financial institutions having correspondent banking accounts with, or processing a sterling payment to, from, or via Sberbank
  - Providing financial services for the purpose of foreign exchange reserve and asset management to:
    - The Central Bank of the Russian Federation;
    - The National Wealth Fund of the Russian Federation;
    - The Ministry of Finance of the Russian Federation; or
    - An entity owned or controlled by, or acting on behalf/at the direction of any of the above three entities

The current situation: new UK trade sanctions

- Prohibitions on the export to or for use in Russia of:
  - Military and dual-use goods and technology
  - “Critical-industry” goods and technology
  - Space and aviation goods and technology

Challenges

- Compliance with three (plus) broadly aligned but inconsistent sanctions regimes
- Each sanctions regime has a broad jurisdictional reach
    - Some are more extraterritorial than others
- Each of these sanctions regimes is in a state of flux: more sanctions are likely
    - Time-lags between announcement of sanctions and adoption of legislation
- Lack of guidance or clear definitions
    - NB in particular the scope of person “connected with Russia”

Challenges

- Legal risks aside, there are practical complications of any dealings with Russia (e.g., transfers related to Sberbank)
- Beware the impact of Russian countermeasures
- Particular need for financial institutions to be vigilant for circumvention and evasion attempts
- We can expect aggressive enforcement – even in Europe

Commentary from the FCA in light of Russian sanctions: MAR and cryptoassets

Jonathan Ritson-Candler

FCA reminds firms of obligations under MAR

- FCA published a short update on its website telling issuers of securities in-scope of MAR to be mindful of their disclosure obligations under MAR in light of the Russian sanctions
- Particularly the obligation to disclose inside information unless there's a legitimate reason for delayed disclosure
- FCA states that "both the invasion and responses to it by governments globally may alter the nature of information that is material to a business' assets, operations and prospects"
- Typical for the FCA to put out pronouncements such as this (e.g., Covid)

Joint statement on sanctions and the cryptoasset sector

- The FCA, OFSI and PRA published a joint statement that all UK financial services firms, including the cryptoasset sector, are “expected to play their part in ensuring that sanctions are complied with”
- The statement reiterates that a cryptoasset should not be treated any differently to any other asset type in relation to sanctions
- Firms are reminded of their obligations under POCA and TACT and encouraged to file SARs if necessary
- FCA encourages firms to check FCA and equivalent overseas registers to ensure that cryptoasset firms they are dealing with are correctly registered
- Statement provides practical guidance firms should use as a checklist to ensure that they have checked (and updated where necessary) AML and CTF systems and controls, particularly in relation to cryptoassets

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PRA Operational Resilience

Jonathan Ritson-Candler

PRA proceeds with amendments set out in CP 21/21

- PRA published Policy Statement 2/22 on 11 March which set out the final rules on operational resilience for CRR firms, Solvency II firms and Financial Holding Companies
- The policy statement largely confirms consultation paper 21/21 from November 2021
- The PRA now has specific power, under s.192XA of FSMA, to make rules applying to approved and designated financial and mixed activity holding companies where it appears to the PRA to be necessary or expedient to make the rules for the purpose of advancing any of its objectives

PRA proceeds with amendments set out in CP 21/21

- PRA is using s.192XA to change Chapter 8 of the Operational Resilience Part of the PRA rulebook to impose current obligations on firms which are part of a group and/or consolidated group to instead impose those rules on the holding company
- The rationale being that this gives effect more directly to the PRA's policy intention to have a "group-level view" of operational resilience to ensure that "the risks of the whole group, including those parts that are not subject to individual requirements, are taken into account"
- The PRA has finalised that it will apply the group provisions in the Operational Resilience Part of the PRA Rulebook relevant to CRR firms to financial and mixed activity holding companies

PRA proceeds with amendments set out in CP 21/21

- The PRA's intent is that the amendments replicate the existing obligations for group arrangements and transfer the responsibility for compliance with those obligations from the firm to the holding company
- CRR consolidation entities are required to comply within a "reasonable time" and no later than 30 June 2022
- PRA has clarified that important group business services should, for CRR firms, be identified in relation to the CRR consolidation entity's consolidation group
- New rules have been introduced to Chapter 8 of the Operational Resilience Part requiring CRR consolidation entities to assess the ability of group members to remain within impact tolerances for their important group business services and to ensure the CRR consolidation entity's board approves the CRR consolidation entity's assessment

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HM Treasury’s Wholesale Markets Review Consultation Response: the approach ahead

Nicola Higgs

Wholesale Markets Review – Consultation Response

- **July 2021**: HMT launched the Wholesale Markets Review to determine how the UK's approach to regulating secondary markets needs to adapt post-Brexit, and to ensure that the framework is flexible enough to adapt to future challenges and opportunities
- This Review is taking place alongside various other initiatives, as the Government looks to reassess the UK's approach to regulation post-Brexit. In particular, the Future Regulatory Framework review (FRF) is considering how regulation in the UK can be made more "nimble" and "agile", by delegating more power to regulators and returning to a more principles-based approach to regulation
- **1 March 2022**: Treasury set out its response

Wholesale Markets Review – Consultation Response

- **Trading venues**
  - FCA will consult on new guidance to clear up uncertainty on the regulatory perimeter for trading venues. The legal definition of a multilateral system will not be amended
  - MTF and OTF Operating Conditions: FCA to consider the case for removing the matched principal trading restrictions for investment firms operating a trading venue, while retaining conflicts obligations (i.e. conflicts concerns raised about allowing investment firms to operate an SI and OTF within the same legal entity)
  - SME markets: The government will continue to explore the proposal for a new type of venue for SMEs and engage with market participants as it develops its policy
  - Market outages: FCA plans to discuss ways to improve market resilience in the case of outages with market participants. The Government will bring forward legislative changes in relation to the reference price waiver (RPW) to delegate the pre-trade equity waivers regime to the FCA when parliamentary time allows

Wholesale Markets Review – Consultation Response

- **Systematic internalisers**
  - The Government intends to proceed with its plan to revert to a qualitative definition of SIs so that firms do not have to carry out complex calculations for this purpose and will bring forward legislation when parliamentary time allows
  - FCA will consult in the first half of 2022 on the simplification of the SI reporting regime. Other changes to the SI regime are considered best made through the FRF and, therefore, will be matters for the FCA to consider and take forward following the implementation of that review
  - On the specific restrictions to midpoint execution, the Government believes that these might not be required so long as SIs consider their use of it and whether that is consistent with their best execution obligations

Wholesale Markets Review – Consultation Response

- **Equity markets (1)**
  - On 23 November 2021, the Economic Secretary to the Treasury committed to bring forward legislation to remove the Double Volume Cap
  - The FCA will continue to monitor the level of dark trading and its ability to limit it if there is evidence that the volume of such trading is undermining the efficiency of the price formation process
  - Reference price waiver (RPW) is seen as a priority area. Legislation will be brought forward to delegate the pre-trade equities waivers regime to the FCA; changes to the type of benchmark that can be used for RPW will then be a matter for the FCA to take forward. The FCA plans to consult in the first half of 2022 on the changes to the RPW and extending the concept of the most relevant market in terms of liquidity to include overseas trading venues. The government states that this will "formalize and broaden the approach that is currently being taken in relation to EU and Swiss shares"

Wholesale Markets Review – Consultation Response

- **Equity markets (2)**
  - On 23 November 2021 the Economic Secretary to Treasury committed to bring forward legislation to remove the share trading obligation. The abolition of the STO will not include the deletion of Article 23(2) of MiFIR (which sits in the STO article) as it helps to delineate the distinction between bilateral and multilateral trading and prevents a crossing network by a firm that does not have a trading venue permission
  - Market making strategy for algorithmic trading: the Government will remove the requirement for these firms to enter into market making agreements with trading venues. This will be delivered by FCA through the FRF review
  - Ticks sizes: a number of amendments were consulted on to correctly calibrate the UK markets and reduce regulatory burdens. The Government noted concerns raised about delegating the tick size regime to venues and said that it does not intend to make changes to the regime “at this moment in time” and any future amendment will be delivered through the implementation of the FRF review

Wholesale Markets Review – Consultation Response

- **Fixed income and derivative markets**
  - Legislation will be brought in to deliver the Government's proposals relating to the derivatives trading obligation (DTO) and to exempt post-trade risk reduction (PTRR) services from the clearing obligation
  - Transparency changes (scope, pre and post-trade, and liquid market determination): The current regime does not cater for the specific and often bespoke nature of fixed income and derivatives markets. The Government intends to delegate this transparency regime to the FCA

Wholesale Markets Review – Consultation Response

- **Commodities derivatives**
  - The government will undertake further analysis of the FSMA regulatory perimeter and the complexities and inconsistencies around the use of the definition of "commodity derivatives" across regimes. Changes to the position limits regime will involve legislation when parliamentary time allows to revoke the requirement for position limits to be applied to all exchange-traded contracts, and the setting of position limits will be transferred from the FCA to trading venues
  - Secondary legislation will be brought forward under existing powers to revoke the current ancillary activities test, re-introducing the "commodity dealer exemption" and remove the annual notification requirements
  - Oil market participant (OMP) and energy market (EMP) regimes: The Government will continue to review the proposal to abolish the OMP and EMP regimes and bring the affected firms into the scope of MiFIR

Wholesale Markets Review – Consultation Response

- **Market data**
  - The Government is committed to help progress the emergence of a consolidated tape and has decided to make legislative changes to ensure that the FCA has all the necessary tools to take this forward
  - The FCA will consult on Transparency changes (scope, pre and post-trade, and liquid market determination): The current regime does not cater for the specific and often bespoke nature of fixed income and derivatives markets
  - The FCA published a feedback statement on 11 January 2022, ‘Accessing and Using Wholesale Data’ setting out proposed next steps. It plans to undertake a significant work programme, and an information gathering exercise will be conducted in Spring 2022 which will focus on pricing of trading data, underlying costs and the terms and conditions of the sale of trading data. During 2022, a consultation will also consider changes to equities and non-equities trade reporting standards in order to improve the usability of trade data

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Sustainable Finance Roadmap 2022-2024: highlights on what ESMA sees ahead

Anne Mainwaring

ESMA Sustainable Finance Roadmap 2022 – 2024

- On 10 February ESMA published its Sustainable Finance Roadmap which sets the priority areas and related actions for ESMA for the period 2022 – 2024
- Actions to address the challenges in the sustainable finance space have been grouped into three main areas which constitute the three priorities for ESMA's sustainable finance work in this period:
  - Tackling greenwashing and promoting transparency
  - Building NCAs' and ESMA's capacities
  - Monitoring, assessing and analysing ESG markets and risks

Tackling greenwashing and promoting transparency

- In asset management, the unequal understanding of the type of products which are subject to Articles 8 and 9 of the SFDR may lead fund managers to disclose inconsistently under these articles and effectively cause greenwashing in some cases
- In investment services, risks arise with regard to how conduct of business rules such as suitability / product governance and information requirements should be applied when selling ESG products
- In corporate disclosure, greenwashing risk stems from incorrect or omitted information in non-financial statements and prospectuses as well as from a lack of transparency on the limitations of the methodologies and data used to prepare disclosures

Tackling greenwashing and promoting transparency

- ESMA will contribute to EC's planned work on minimum sustainability criteria, or a combination of criteria for financial products that disclose under Article 8 of the SFDR
- Review the regulatory technical standards under SFDR to clarify:
  - Indicators for climate and environment related Principal Adverse Impacts (PAI)
  - PAI on social and employee matters, respect for human rights, anti-corruption and anti-bribery matters
- Analyse disclosures under SFDR Article 8 and 9 in the investment management sector to support supervisory convergence efforts and the identification of greenwashing cases

Building NCAs’ and ESMA’s capacities

- Facilitating the exchange of knowledge and information on ESG-related initiatives between NCAs
- Organising regular supervisory and enforcement case discussions in relevant ESMA standing committees and networks
- Develop common supervisory standards on key ESG-related matters

On the horizon

- Social taxonomy
- Corporate sustainability due diligence directive

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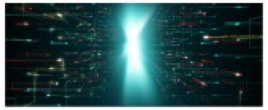

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