Financial Markets Law Committee ("FMLC")

Infrastructure Scoping Forum

Date: Monday 20 March 2017

Time: 9.00am to 10.30am

Location: Bank of England, Threadneedle Street, London EC2R 8AH

In Attendance:

Simon Gleeson (Chair)	Clifford Chance LLP
Antony Beaves	Bank of England
Nick Carew-Hunt	
Dorothy Delahunt	London Derivatives Exchange
Adam Eades	BATS Chi-X Europe
Nathaniel Lalone	Katten Muchin Rosenman UK LLP
Iona Levine	Minerva Chambers
Nina Moffatt	Baker McKenzie LLP
Matina Papadopoulou	CHAPS Co
Annie Siddiqui-Feroz	London Derivatives Exchange
Mitja Siraj	FIA
Arun Srivastava	Baker McKenzie LLP
Christopher Twemlow	Euroclear SA/NV London
Rachel Toon	FMLC
Thomas Willett	FMLC

Regrets:

William Ingram	CME Group
Lewis Lee	CLS Bank International
Paul Watkins	

Minutes:

1. Introduction (Simon Gleeson)

1.1. Simon Gleeson (Chair) opened the meeting and provided a brief introduction.

2. CCP Resolution (Dorothy Delahunt and Annie Siddiqui-Feroz)

2.1. A list of issues concerning the European Commission proposal on Central Clearing Counterparty ("CCP") resolution was discussed.[1]

2.2. The members agreed that the proposal was unclear in places, highlighting the following as particular areas of uncertainty that could be addressed:

- the issue of initial margin haircutting;
- what is meant by "no creditor worse off", and the lack of analysis concerning what happens to clearing members;
- the failure of the proposal to address the differences between vertically and horizontally integrated CCPs; and
- the different approach that should be taken when negotiating client clearing and if clients should become members of the CCP.

2.3. The Financial Stability Board ("FSB") paper on CPP resolution was noted as a source of reference for the Forum. Participants were encouraged to send any further papers or resources to the FMLC Secretariat for distribution to the Forum members.

3. The Boundary between "multilateral" and "bilateral" trading activities (Nathaniel Lalone)

3.1. Nathaniel Lalone recapped the issues surrounding the boundary between "multilateral" and "bilateral" trading activities, which was first introduced at the previous meeting on 12 December 2016, referring to his earlier write-up of the issue.[2]

3.2. The Forum agreed that greater clarity and policing is needed to determine the line between the regulated activities of arranging deals in investments and operating an organised trading facility ("OTF").

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[1] Please see Appendix I below.

[2] Please see Appendix II below.

3.3. It was recommended that this and other work could be done ahead of the European Securities and Markets Authority ("ESMA") publishing guidance this year, and that future Forum meetings might explore what specific clarifications need to be made.

3.4. A recommendation to seek further clarification from the Financial Conduct Authority ("FCA"), potentially accompanied by a recommended approach to distinguishing between arranging and operating an OTF, was proposed as a possible solution to these uncertainties.

4. Issues with the CRR 'look-through' requirements arising from the recent European Banking Authority ("EBA") and ESMA Report (Mitja Siraj)[3]

4.1. In the context of the *Report on the Functioning of Regulation (EU) No 575/2013 (CRR)* published in January 2017 by the European Banking Authority ("EBA") and ESMA, Mitja Siraj outlined the CRR look-through requirements under Article 305, and addressed issues potentially seen as arising.[4]

4.2. Among these issues are 1) several definitional uncertainties regarding terms which are used in the CRR but not defined (including "bear no losses" and "segregated and distinguished"); 2) a lack of clarity around the client actions needed to satisfy the porting requirement in Article 305(2) and 3) inconsistency with U.S. requirements.

4.3. Mr Siraj suggested that further clarity is still required to interpret and understand key terms in Article 305 of the CRR. The requirements, for this reason, present problems for firms.

4.4. Members took the view that it would be beneficial if the Commission could clarify what the requirements mean and they recommended that the FMLC consider contacting the European Commission in this regard. Further, members expressed a wish to monitor further developments in this area.

5. The new payments world: nuts and bolts (Arun Srivastava)[5]

5.1. Arun Srivastava presented on payment services and open banking under Directive (E.U.) 2015/2366 on payment services in the internal market ("PSD2"), highlighting the

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[3] Please see Appendix III below.

[4] Available at: https://www.eba.europa.eu/documents/10180/1720738/Report+on+the+interaction+with+EMIR+(ESAS-2017-82+).pdf

[5] Please see Appendix IV below.

concern that new entrants to the banking market are not being granted access to the payments market to compete with banks.

5.2. Among the uncertainties to which the new regime gives rise, Mr Srivastava observed, are residual questions about the regulatory and licencing requirements which will apply to third parties and what steps may be required under Article 20 PSD2 in order for payment institutions to avoid liability for third parties' actions. Another area of concern is the interplay between Open Banking, the PSD2 and GDPR. Tensions exist between the desire to protect data on the one hand and the desire to increase the flow of data between participants in the banking and payments industry to encourage competition. The members of the Forum discussed this question further and identified third party fraud as an interesting case study.

6. Clearing after Brexit

6.1. E.U.-U.S. mutual CCP recognition under the equivalence requirements set out in Regulation (E.U.) No 648/2012 on OTC derivatives, central counterparties and trade repositories ("EMIR") became a politicised and difficult process. After Brexit U.K. CCPs will need to pass the equivalence threshold in order to obtain recognition under EMIR for the purpose of offering clearing services in the E.U. This process may be challenging. Participants referred here to work on *CCPs Post-Brexit* by the International Regulatory Strategy Group ("IRSG").[6]

6.2. The Forum concluded to keep "Clearing after Brexit" as a standard agenda item for subsequent meetings.

7. Forum administration

7.1. FMLC Senior Administrator, Rachel Toon, outlined the remit of the FMLC, the practical meaning of "legal uncertainty" within this remit, the mission which derives from the remit, the role of scoping fora within this mission, the six purposes which are fulfilled by the eight scoping fora which the FMLC has established so far and the questions which it would be helpful for members to address in 2017.[7]

7.2. The procedure of publishing Forum documents on the FMLC website within the public domain was outlined.

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[6] Available at: http://www.irsg.co.uk/assets/IRSG-Paper-on-CCPs-Post-Brexit.pdf.

[7] Please see Appendix V below.

7.3. Membership of the Forum was discussed and, in particular, the question was raised whether lawyers in private practice who regularly act as guest speaker or as chair-by-invitation should be invited to join the Forum but no decision was taken. The discussion was deferred.

8. Any other business

8.1. No other business was raised.

Appendix I

CCP Resolution

Background:

- A CCP acts as the intermediary to both sides of a transaction in a financial instrument, including bonds, equities, derivatives and commodities (such as agricultural products, oil and natural gas).
- A public consultation on a possible recovery and resolution framework for non-bank institutions was carried out by the European Commission between 5 October and 28 December 2012. It inquired about the need for recovery and resolution arrangements mainly in relation to CCPs, central securities depositories and insurance undertakings. On the whole, the consultation indicated that the priority should be to develop EU-wide recovery and resolution rules for CCPs. The implementation of the G20 requirement for standardised OTC derivatives to be centrally cleared was recognised as a compelling argument in favour of taking action.
- At the international level, G20 leaders have endorsed the approach developed by the Financial Stability Board (FSB) to address the risks which the failure of any financial institution (bank, financial market infrastructure, insurance undertaking, etc.) of global systemic relevance could have on the financial system via comprehensive and appropriate recovery and resolution tools. Furthermore, the Committee on Payment and Market Infrastructures (CPMI) and the International Organisation of Securities Commissions (IOSCO) have developed guidance on recovery plans for financial-market infrastructures, including CCPs, while the FSB has issued further guidance on the application of its Key Attributes of Effective Resolution Regimes to financial market infrastructures such as CCPs. This guidance has been reflected in the Commission's proposal.

CCP resolution:

- The proposed rules for CCPs set out provisions comparable to those in the recovery and resolution rules for banks (Bank Recovery and Resolution Directive– BRRD) and are based on international standards.
- However, as CCPs are very different businesses to banks, this proposal contains CCP-specific tools that better align with CCPs' default management procedures and operating rules, especially to determine how losses would be shared. The proposed rules require CCPs and authorities to prepare for problems occurring, intervene early to avert a problem, and step in when things have gone wrong.
- The proposed rules require CCPs to draw up recovery plans which would include measures to overcome any form of financial distress which would exceed their default management resources and other requirements under EMIR. This should include scenarios involving defaults by clearing members of the CCP as well as the materialisation of other risks and losses for the CCP itself, such as fraud or cyber attacks. Recovery plans are to be reviewed by the CCP's supervisor.
- Authorities responsible for resolving CCPs (i.e. resolution authorities) are required to prepare resolution plans for how CCPs would be restructured and their critical functions maintained in the unlikely event of their failure.

- Early intervention will ensure that financial difficulties are addressed as soon as they arise and problems can be averted. CCP supervisors are granted specific powers to intervene in the operations of CCPs where their viability is at risk but before they reach the point of failure or where their actions may be detrimental to overall financial stability.
- A CCP will be placed in resolution when it is failing or likely to fail, when no private sector alternative can avert failure, and when its failure would jeopardise the public interest and financial stability. In addition, it could be placed into resolution where the use of further recovery measures could compromise financial stability even when the conditions above are not met.
- The analysis for the need to respond to the possible recovery and resolution of other financial firms than banks and CCPs is still underway. This is mainly due to the lessons learned during the financial crisis which did not demonstrate an equally urgent need for such measures. However such measures may be necessary in the future, taking account of the development of economic and financial risk in the sectors concerned.

Objectives:

The main objectives of the proposal are:

- To ensure that CCPs' critical functions (i.e. those functions and services that are necessary for the financial markets to work) are preserved while maintaining financial stability,
- To help to prevent taxpayers from bearing the costs associated with the restructuring and the resolution of failing CCPs and
- To avoid any unnecessary destruction of value (i.e. higher losses or costs associated to the resolution actions that would otherwise be required to meet the resolution objectives).

The proposal lays out a comprehensive set of measures which aim to ensure that:

- National resolution authorities are designated in each Member State. These could be national central banks, ministries or the existing supervisory authorities.
- National supervisory authorities, as designated under EMIR, are given the tools and powers to intervene in a CCP that is infringing or likely to infringe its prudential requirements and at a sufficiently early stage to address developing problems in a CCP's financial situation;
- CCPs and national supervisory and resolution authorities are adequately prepared for any crisis;
- National resolution authorities have harmonised resolution tools and powers to take rapid and effective action when a CCP failure cannot be avoided;
- National resolution authorities cooperate effectively, including with third country competent authorities.
- The framework takes into account the global and systemic nature of CCPs. It provides for close coordination between national competent authorities in order to ensure that resolution actions are applied in a coherent manner taking into consideration the impact on affected stakeholders and financial stability.

The key elements of the proposal are:

- The framework will be based first on prevention and preparation. CCPs (subject to the approval of supervisory authorities) and resolution authorities are required to draw up recovery and resolution plans respectively on how to handle any form of financial distress which would exceed a CCP's existing resources. If resolution authorities identify obstacles to resolvability in the course of the planning process, they can require a CCP to take appropriate measures including changes to its operational or legal structure or to its pre-funded loss-absorbing resources on a case-by-case basis to ensure that it can be resolved with the available tools in a way that does not threaten financial stability and does not involve costs to taxpayers.
- Supervisory authorities have the powers to intervene at an early stage (i.e. before the problems become critical and the financial situation deteriorates irreparably) when a CCP is in breach of, or is about to breach, its prudential requirements under EMIR. These powers would complement those in EMIR, constituting specific supervisory options in these circumstances. Amongst others, competent authorities could require the CCP to undertake specific actions in its recovery plan or to make changes to its business strategy or legal or operational structure.
- The framework will provide national authorities with resolution tools. While minimising the extent to which the cost of a CCP's failure is borne by Member States and their taxpayers, these tools should ensure that essential clearing functions and services are preserved without the need to bail out the CCP, and that shareholders bear an appropriate part of the losses.

Issues:

- The issue of initial margin haircutting is to be used as a last resort in the CCP resolution and is only applied to initial margins that are not bankruptcy-remote. This means there is no mention of initial margin haircuts as a tool to cover default losses.
- If CCP was to fail then it would have a huge impact on the financial stability as they have pushed more than 60% of O-T-C derivatives market into central clearing, so there should be more review of the current financial stability of the market and there should be more mitigating factors available.
- There is no general approach for partial tear-up of contracts in advance. Whilst the CCP does have a range of tools such as soliciting voluntary actions, auctions, tear-ups and contract termination, full tear-up of contracts is considered a last resort and does not have systematic consequences.
- If the failure of CCP leads to an impact on financial stability then authorities need to have arrangements in place to deal with it. There are no legal powers or tools provided if a crisis occurs.
- The no creditor worse off Safeguard (NCWO) should be clear and concise. The big question at the last meeting was the payment of difference, who is going to pay? How do you demonstrate you are worse off?

Appendix II

Katten
Katten Muchin Rosenman UK LLP

DRAFT: 24 February 2017

MiFID II – Multilateral v. Bilateral Systems

- Article 1(7) of MiFID II states:

  "All multilateral systems in financial instruments shall operate either in accordance with the provisions of Title II concerning MTFs or OTFs or the provisions of Title III concerning regulated markets".

- Therefore, any system that qualifies as "multilateral" must operate as an RM, MTF or OTF.

- Article 4(19) of MiFID II defines "multilateral system" as:

  "Any system or facility in which multiple third-party buying and selling trading interests in financial instruments are able to interact in the system".

- In December 2015, the FCA issued a consultation paper (CP15/43)[1] on MiFID II in which it proposed the following further guidance on the term "multilateral system":[2]

  We are of the view that interaction in a system or facility occurs when the system or facility allows multiple trading interests to exchange information relevant to any of the essential terms of a transaction in financial instruments (being the price, quantity and subject-matter) with a view to dealing in such instruments. The information exchanged need not be complete contractual offers, but may be simply invitations to treat or 'indications of interest'.

  At a minimum, therefore, a platform will be considered a multilateral system (and hence must operate as a RM, MTF, or OTF in accordance with article 1(7) of MiFID II) if the system provides the ability for trading interests to interact with a view to dealing and:

  - *allows multiple participants to see such information about trading interest in financial instruments, or submit such information about trading interest in financial instruments for matching, and*

  - *enables them, through technical systems or other facilities, to take steps to initiate a transaction, or be informed of a match.*

  A system that provides participants confirmation or notification messages about a matching opportunity between those participants, with a view to a transaction in financial instruments, qualifies as such a system or facility.

- The FCA's proposed guidance therefore sets the threshold for "multilateral system" quite low and would include systems that:

  - allow multiple parties merely to "exchange information" "with a view" to trading;

  - allow multiple parties to see/submit "information" and "take steps" to "initiate" a trade; and

  - provide parties with "notifications" of an "opportunity" to trade.

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[1] Available at: https://www.fca.org.uk/publication/consultation/cp15-43.pdf.

[2] *See* ¶¶ 11.10-11.12 of CP 15/43.

- The proposed threshold for qualifying as a "multilateral system", and therefore the obligation to operate as a regulated market, MTF or OTF has a number of implications for market participants, including in particular the following.

  - Arranging. "Arranging deals in investments" and "making arrangements with a view to transactions in investments" are both regulated activities that traditionally capture a number of service providers that offer communications facilities that, for example, notify participants about trading opportunities/interests or that allow negotiation to occur within the system.

    - These systems either stayed outside the regulatory perimeter entirely, or required authorisation as arrangers only, on the basis of various criteria, often including that execution did not occur within their systems and/or because there were no formal bids and offers communicated between parties.

    - These "arranging" systems may now fall within the scope of the FCA's understanding of the term "multilateral" and would therefore need to operate as a regulated market, MTF or OTF.

    - However, operators of these systems might reach different conclusions as to their "multilateral" nature which could create material differences between operators regarding compliance obligations. Some may exit the market.

  - OTC Brokerage. Many OTC brokers have traditionally traded with their clients while hedging those positions with other financial institutions, often market makers. There is consequently some amount of "pass-through" of the market makers' prices to the broker's underlying clients.

    - If this is treated as bilateral trading, the broker would likely need to contend with systematic internaliser ("**SI**") compliance requirements, which introduce a series of complications, in particular how the broker could continue to access hedging trades if the market makers are themselves SIs or have to become operators of OTFs or MTFs.

    - There is a risk that the broker's activities could be considered multilateral trading to the extent that the broker's role is characterised as passing through price information and facilitating trades between its clients and the market makers, with the broker standing in the middle.

      - This brokerage model may not be compatible with operating as an OTF, in particular relating to discretionary versus non-discretionary execution of orders.

      - OTFs are subject to strict limits on acting on a matched principal basis by standing between participants in the system.

    - All participants in this chain of transactions – clients, brokers, market-makers – must grapple with their regulatory characterisations under MiFID II, and therefore a given participant's chosen solution may not correspond to another participant's solution (e.g. the prohibition on interactions between SIs and OTFs), giving rise to an uncommonly high level of uncertainty.

- Accordingly, the FCA's proposed implementation of the regime applicable to multilateral systems gives rise to a greater-than-usual amount of legal uncertainty for a number of market participants, many of which will need to decide in the near future how best to adjust their business models to comply with the new regime taking effect on 3 January 2018.

Appendix III

20 March 2015

Capitalisation of client exposures to clearing members

Challenges with CRR Article 305 and the 'look-through' requirements

FMLC Infrastructure Scoping Forum

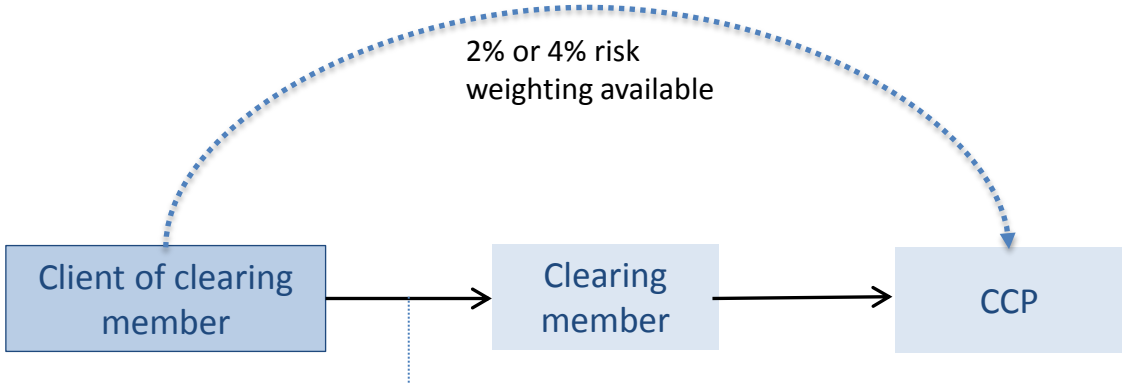
FIA

Agenda

1. Setting the scene
2. Overview of CRR 305 requirements
3. Interpretation of CRR
4. Basic 'look-through' concept
5. Legal opinion requirement
6. International perspective – the US angle

Setting the scene - capital requirements

Position of client



Exposures to clearing member

1. Art 305(1): **bilateral risk weighting** applies
2. Art 305(2): **2% risk weighting** available if segregation/bankruptcy remoteness/transfer conditions satisfied
2. Art 305(3): **4% risk weighting** if no protection against joint default of clearing member and another client

CRR 305(2) requirements – 2% risk-weighting…

Clients of clearing members shall apply a bilateral risk weighting for their exposures to the CM in relation to the CCP-related transactions, unless certain conditions in CRR Article 305(2) are met which make risk-weighting of 2% or 4% available.

See the last slide: no legal opinion requirement in the US

the segregation of positions and assets of the client at the level of both the CCP and the CM from the positions and assets of both the CM and the other clients of the CM (the '*segregation condition*')

and

that the result of such segregation is that the client's assets and positions are bankruptcy remote in the event of default/insolvency of the CM or one or more of its clients (the '*bankruptcy remoteness condition*')

laws, regulations, rules and contractual arrangements applicable to or binding that institution or the CCP must facilitate the transfer of the client's positions (the '*porting condition*')

the institution has available an independent, written and reasoned legal opinion that concludes that, in the event of legal challenge, the relevant courts and administrative authorities would find that the client would bear no losses on account of the insolvency of its clearing member or of any of its clearing member's clients under the laws of certain jurisdictions (the '*legal opinion requirement*')

the CCP is a QCCP

…and CRR 305(3) requirements for 4% risk-weighting

To achieve 4% risk weighting all conditions from the previous slide must be met, although the client is not protected from losses in the case of a 'double default' (i.e. default of the CM and one of its other clients).

The EBA has issued a Q&A on gross omnibus segregation structures in an attempt to provide some clarity around the application of 4% RW, but the Q&A has created further interpretation queries.

Q: Please confirm that the criteria in Article 305(2)(a) is met with gross omnibus segregation solutions that provide the same level of segregation as individual segregation (e.g. account segregation with asset-tagging, where good individual asset attribution yields the same results as individual segregation).

- ***A:*** *[…Therefore, the CRR clearly requires use of a clearing account that provides at least an equivalent level of client protection as individual client segregation. In order to benefit from the 2% risk weight the client must not be exposed to risk arising other than from its own positions and assets. If the client is exposed to a double default of its clearing member and another client, or to a loss of value of other clients' collateral, then it should not benefit from the 2% weighting. 'Asset-tagging' or 'good individual asset attributions' do not necessarily guarantee this condition nor the other conditions laid down in Article 305(2) of the CRR in practice.*
- *In the instance where a client faces fellow client risk, as described in Article 305(3) of the CRR, where an institution that is a client is not protected from losses in the case that the clearing member and another client of the clearing member jointly default, they may benefit from the 4% risk weight so long as all other conditions of Article 305(2) are met. This would also include the condition that the positions and assets of that institution related to their CCP-related transactions are still distinguished and segregated at the level of both the clearing member and CCP, from the positions and assets of both the clearing member and the other clients of that clearing member. Following this, gross omnibus segregation (legal segregation & operational comingling) may be an acceptable level of segregation for institutions if they can demonstrate to offer the aforementioned level of protection….]*

Interpretation of CRR

"**bankruptcy remote**" is defined in article 300(1) of the CRR

We believe that in the context of CRR Article 305 it is not necessary to consider the effect of the insolvency or reorganisation measures in respect of the CCP, because Article 305 doesn't speak of insolvency of the CCP.

"**bear no losses**" is not defined in the CRR

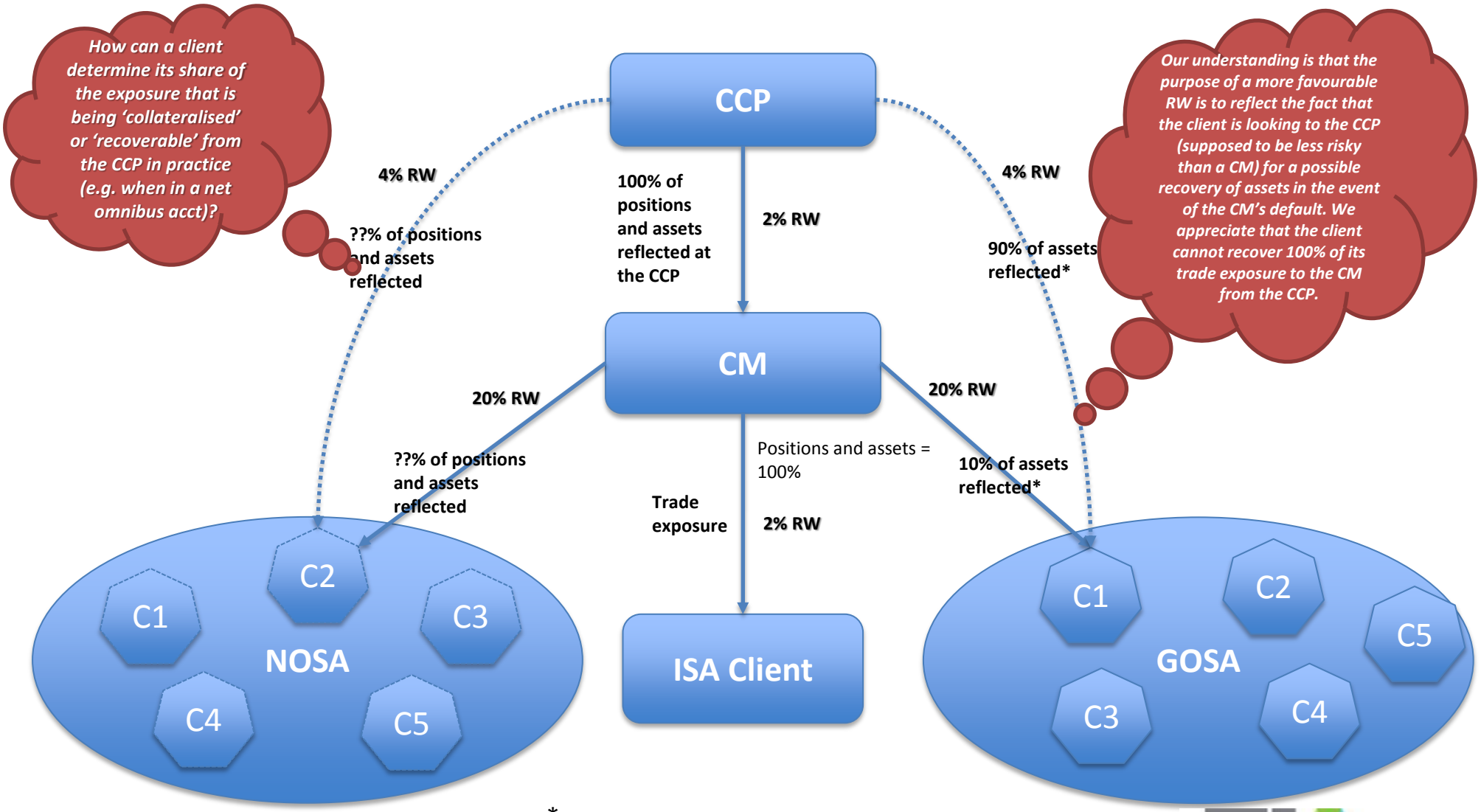
We believe that the phrase means that in the event of the insolvency of the clearing member or one of its other clients, the client's positions and assets at the CCP level would not be diminished as a result of the insolvency of the clearing member or its other clients.

For the purpose of CRR Article 305 we do not believe that losses resulting out of e.g. market risk, custody risk, investment losses, fraud, etc. are relevant. These risks would not be relevant for CMs in the context of their trade exposure to the CCP.

"**segregated and distinguished**" is not defined in the CRR

We understand that this term shouldn't be interpreted more broadly than the meaning given to "individual client segregation" and "omnibus client segregation" in Article 39 of EMIR. The Article 305 requirements should be capable of being met also when a QCCP is a 'recognised' (=non-EU) CCP to which EMIR Article 39 segregation doesn't apply.

Basic 'look-through' concept - ISA and OSA segregation



* % used just as an example to illustrate the concept

Legal opinion requirement - relevant jurisdictions

Article 305(2)(c) of the CRR identifies which laws are considered to be relevant for the purposes of an analysis of whether a client would "bear no losses" on account of the insolvency of its clearing member or of any of its clearing member's clients.

Relevant jurisdictions:

- ✓ the law applicable to the jurisdiction of the CCP
- ✓ the law applicable to the jurisdiction of the CM
- ✓ the law applicable to the jurisdiction of the client
- ✓ the law governing the arrangements for a transfer of the client's positions and assets in the event of default of a CM
- ✓ the law governing contracts cleared at the CCP
- ✓ the law governing the [client's] collateral

Relevance of client's jurisdiction

- Could the opinion given with respect to the client's jurisdiction in any way undermine analysis and conclusions reached in the other legal opinions, in particular the ones given under the laws governing the CCP and the CM? Under English law, our analysis has shown that no such interference would be recognised.

Law governing collateral

- It could mean multiple laws, as the requirement is not specific enough. We believe it should be interpreted as the law governing collateral arrangement.

International perspective - US rules on 'look-through' RW

How do European rules fit into/compare with other prudential regimes? Is there a level-playing field in terms of Basel III implementation as regards capitalisation of client exposures?

In the US, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) believe that omnibus accounts (that is, accounts that are generally established by clearing entities for non-clearing members) in the United States would satisfy the favourable risk weighting requirements because of the protections afforded client accounts under certain regulations of the SEC and CFTC.
(See Securities Investor Protection Act of 1970, 15 U.S.C Section 78aaa – 78lll; 17 CFR part 300; 17 CFR part 190.)

In order for a transaction to qualify as a 'cleared transaction' the transaction must meet a number of conditions, including:
'(2) The collateral supporting the transaction must be held in a manner that prevents the Board-regulated institution from facing any loss due to an event of default, including from a liquidation, receivership, insolvency, or similar proceeding of either the clearing member or the clearing member's other clients. Omnibus accounts established under 17 CFR parts 190 and 300 satisfy the requirements of this paragraph (a).' (Emphasis added.)

CONCLUSION: Automatic application of 2%/4% RW to all client exposures arising out of QCCP-related transactions. No legal opinions required.

QUESTIONS

Baker McKenzie.

Appendix IV

Payment Services & Open Banking

Open Banking (1)

- Open Banking Working Group (“OBWG”) in 2016 recommended the creation of an Open Banking Standard that will make it possible for banking data to be shared and used securely:
  - bank data, including information about banks’ products and services, should be made available as **open data**, so that services can be built allowing customers to get more out of their financial relationships (for example, through product comparison services);
  - open APIs should be created to enable services to be built using bank and customer data. These would include open data about products and services as well as **shared data** about bank transactions that individuals or businesses can **choose to share** themselves through secure and controlled means.
- The OBWG's proposals are broader in scope than PSD2.

Open Banking (2)

- Final report of the Competition and Markets Authority's (CMA) retail banking market investigation was published in August 2016.

  "*Essentially, the older and larger banks, which still account for the large majority of the retail banking market, do not have to work hard enough to win and retain customers and it is difficult for new and smaller providers to attract customers*."

- Propose a package of remedies – "Foundation measures" (e.g., an open banking standard) aimed at underpinning increased competition. These will be accompanied by measures specifically directed to certain aspects of the market: current account switching, PCA overdrafts, and the needs of small business.
- *Open API Standard for Banking* to permit authorised intermediaries to access information about bank services, prices and service quality and customer usage. This will enable new services to be delivered that are tailored to customers' specific needs.
- Secondly, the CMA is requiring banks to publish core indicators of service quality based on customers' willingness to recommend their bank to friends, family or colleagues. Banks will also be required to collect and publish a wider range of additional quality measures, which they will make available through open APIs so that intermediaries can use them in new kinds of advisory and comparison services.

Access to payment systems and accounts

- PSD2 provides for payment systems :
  - access to both payment systems and to payment accounts should be on an objective, non-discriminatory and proportionate basis.
  - rules on access may not go beyond what is necessary to safeguard against specific risks such as settlement risk, operational risk and business risk and to protect the financial and operational stability of the payment system.
  - restrictions on participating in other payment systems and rules which discriminate between payment service providers are prohibited.
- Carve out for payment service providers belonging to the same group, such as true three-party schemes
- PSD2 provides for payment accounts:
  - access must be sufficient to allow firms to provide payment services in an unhindered and efficient manner.
  - access may only be denied by an account provider to other service providers where objective evidence-based reasons (e.g., unauthorised or fraudulent use).

New payment services

Payment initiation services:

A payment initiation service is a service to initiate a payment order at the request of the payment service user with respect to a payment account held at another payment service provider

- A customer will have the right to use a payment initiation service where their account is accessible online. In the context of consumers and retailers such a service offers the potential for cheaper payment transactions without the use of a credit or debit card allowing payment directly from a customer's account.

Account information services:

An account information service is an online service to provide consolidated information on one or more payment accounts held by the payment service user with either another payment service provider or with more than one payment service provider.

- Consumers will be able to access and view all their accounts through a single gateway and login.
- Currently, the use by customers of these services is often contrary to the terms and conditions of their account providers

What are the legal and regulatory issues? requirements?

TPPs will have to follow the same rules as the traditional payment service providers: registration, licensing and supervision by the competent authorities, and step up the security around online payments

Requirements for PISPs

Business and operations information

Governance & internal control mechanisms

Compliance with initial capital requirements

Minimum of capital depending on the services the applying PISP are planning to provide

Evidence of funds above minimum limits

Own funds can not fall below initial capital or a minimum of own funds

Safeguarding of funds

Necessary measures to safeguard all funds received from their customers

Requirements for both PISPs & AISPs

Notification/approval of control of the shareholding

Change in shareholder control surpassing thresholds to the relevant authorities

Registration in Member State & EBA

Register with local authority which communicates registration to the EBA

Requirements for AISPs

Proof of professional indemnity insurance

The minimum monetary amount will be established by EBA

Passporting of PS activities

Obliged to notify the authority of their member state if they wish to provide the services in other Member States

Third Party Payment Services

SITUATION

- PSD2 introduces a regulatory framework for new payment services to cover the activities of TPPs: payment initiation and account information services
- Emerging players and incumbents alike will take new positions and develop consumer oriented value propositions
- Competition may intensify across the payments ecosystem as stakeholders across industries are developing strategies for PSD2

COMPLICATION

- Becoming a TPP is a challenging task for both incumbents and emerging players, and requires aspiring TPPs to understand:
- What role and position they should take
- What services and value propositions the should offer
- How they structure and organize themselves
- What capabilities they need, and how they will be regulated

KEY QUESTION

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Who will aspire to become TPPS in PSD2, and what does it take?

Key questions for emerging TPPs in PSD2

How is PSD2 changing the Payments and Banking industry?

- What new roles are emerging from PSD2 and what is the impact to payment value chains?
- What is the effect on revenue and operational risk for incumbents in the payments industry?
- What players across industries will seek new roles and strategic positions, and why?
- What type of payments ecosystems will emerge?
- What value propositions will new players offer to consumers, corporates and merchants

What new requirements does PSD2 bring for Banks and Trusted Third Parties?

- What accounts and services will banks enable for TPPs though open APIs (compliance ++)?
- What is required to establish as a TPP from a regulatory and licensing perspective?
- What is the implementation timeline and main uncertainties?
- What are leading players across industries doing to prepare for PSD2?

What is needed to succeed as Trusted Third Party in PSD2?

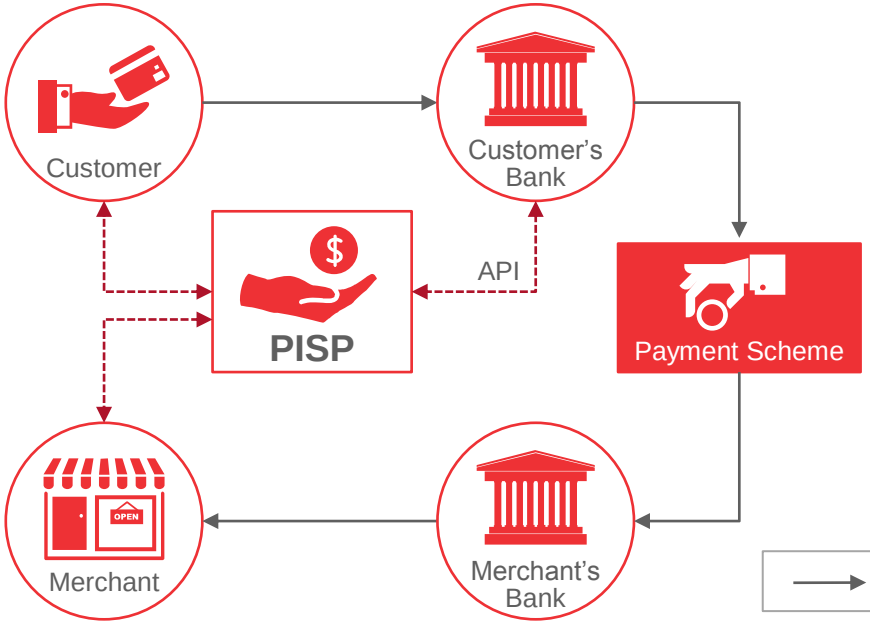
- How do you define your strategic ambition and role in PSD2?
- What are the needed people, process and technology capabilities for becoming a TPP?
- How do you set up the organizational structure for the TPP?
- How do you rig a PSD2 readiness project?

What new roles will emerge?

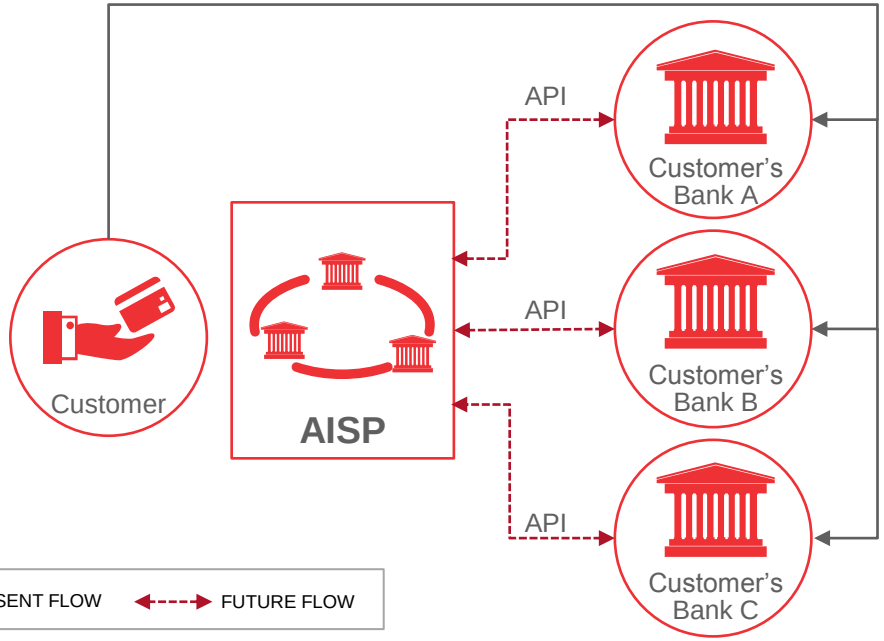
TPPs may take new roles and positions in the bank, merchant and consumer ecosystem

PSD2 mandates the opening up of bank APIs to TPPs. As a result TPPs can now provide payment initiation and account data aggregation services that create new interaction models for banks with merchants and customers

Third-party payment initiation: An updated payment model including a Payment Initiation Service Provider (PISP)



Third-party account access: An updated interaction model including an Account Information Service Provider (AISP)



PRESENT FLOW FUTURE FLOW

Baker McKenzie.

www.bakermckenzie.com

Appendix V

Financial Markets Law Committee Infrastructure Scoping Forum

Monday 20 March 2017

9.00am to 10.30am

Bank of England, Threadneedle Street, London

THE FMLC RADAR FUNCTION:
an introduction

Rachel Toon, Senior Administrator
Financial Markets Law Committee

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FMLC Remit

"The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed."

FMLC Founding Documents, September 2002

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What this means…

"But in my view, legal uncertainty is just another name for legal risk: the risk of increased litigation over legal rights that are poorly defined, the risk of market disruption because legislation has unintended consequences, or the risk that market standard contracts turn out to be unenforceable. These are broadly the sorts of issues the FMLC has been established to tackle."

Joanna Perkins, FMLC Chief Executive

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FMLC Mission

- According to the remit, the FMLC has a tripartite mission:
  - to identify relevant issues (the **radar** function);
  - to consider such issues (the **research** function); and
  - to address such issues (the **public education** function).
- The **radar function** relies on the FMLC's scoping forums and other horizon-scanning, advisory bodies. It also relies on a relationship management programme which the FMLC Secretariat maintains with Patrons and Stakeholders.
- The **research function** is addressed by the FMLC Secretariat and by highly-focused working groups who work to draft papers and correspondence on behalf of the FMLC.
- The **public education function** is furthered when the FMLC publishes these letters and papers. It is also addressed by the regular programme of events organised by the FMLC Secretariat, including: roundtables, seminars and conferences. These feature high-profile guest speakers.

Scoping Forums

"Scoping forums serve as an avenue for the FMLC to engage with focus groups on legal issues affecting specific segments of the financial markets. The forums serve as spaces for discussion of broader issues of legal uncertainty, and members formulate and propose to the FMLC issues considered by them to cause substantive legal uncertainty to their industry."

FMLC Brochure, January 2017

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How Scoping Forums work…

- A scoping forum, then, should serve six key purposes:
  1. to establish a pool of expertise available to the FMLC;
  2. to enable full discussion among interested parties with a view to facilitating collective legal risk assessment;
  3. to guide the FMLC and establish priorities for the expenditure of resources;
  4. to make recommendations to the FMLC as to specific issues to be addressed;
  5. to make non-binding suggestions as to the manner of the FMLC's engagement with the issues; and
  6. to nominate experts to working groups.
- At this time of significant political change, the FMLC Secretariat would be grateful for assistance with items 2-4, in particular.

Questions, questions…

- What are the implications for infrastructure of Brexit?
- Should the FMLC address these questions and, if so, how?
- Assuming the FMLC has limited resources to devote to infrastructure issues, in 2017, which are those that it should prioritise?
- Does the Forum agree that the flow of information between members and the FMLC Secretariat should ideally be a 2-way process? How can the Secretariat best assist the Forum in its discussions?
- Does the Forum agree that the Secretariat should table updates for the Forum on issues which the FMLC considers relevant to the industry, although not a commercial priority (e.g. developments in other jurisdictions)?
- Hitherto, membership of the Forum has been open exclusively to representatives of infrastructure bodies (although lawyers in private practice can participate as Chair or guest speaker on an ad hoc basis). Given the FMLC's charitable status and the complexity of the regulatory reforms under discussion, should this structure be revised?

Summary and Conclusion

To sum up…

- The FMLC is tasked with identifying, considering and addressing legal uncertainty…
- …which is sometimes better thought of as "legal risk".
- The Forum is a means by which the FMLC can fulfil its radar function.
- The Forum serves six key purposes.
- At this time, the FMLC Secretariat would be grateful for help with assessing legal risks, identifying priorities and selecting issues for further work.
- The Secretariat has highlighted questions for possible consideration.