



Financial Markets Law Committee (“FMLC”)

Finance and Technology Scoping Forum

Date: Tuesday 6 August 2019

Time: 9.00am to 10.30am

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

In Attendance:

Sarah Lewis (chair)	Cleary Gottlieb Steen & Hamilton LLP
Nikita Aggarwal	University of Oxford
Scott Farrell (dial in)	King & Wood Mallesons
Jonathan Gilmour	Travers Smith LLP
Suhail Khawaja	Wilmington Trust
Matthew Nyman (dial in)	Uphold
James Reynolds	The Law Society
Ian Stevens	CMS Cameron McKenna Nabarro Olswang LLP
Kathleen Tyson	Granularity Ltd
Virgilio Diniz	FMLC Project Manager
Katja Trela-Larsen	FMLC Forums Coordinator

Regrets:

Antony Beaves	Bank of England
Andrew Harvey	GFMA – Global Financial Markets Association
Richard Hay	Linklaters LLP
Mark Kalderon	Freshfields Bruckhaus Deringer LLP
Ben Kingsley	Slaughter and May
Lewis Lee	CLS Bank International
Adam Sanitt	Norton Rose Fulbright LLP
John Taylor	Queen Mary, University of London
Simon Toms	Allen & Overy LLP
Stuart Willey	White & Case LLP

Registered Charity Number: 1164902.

"The FMC" and "The Financial Markets Law Committee" are terms used to describe a committee appointed by Financial Markets Law Committee, a limited company ("FMC" or "the Company"). Registered office: 8 Lothbury, London, EC2R 7HH. Registered in England and Wales. Company Registration Number: 8733443.

Minutes:

1. Introductions

1.1. The Chair opened the meeting and asked attendees to introduce themselves.

2. The FMLC's Public Education Function: Speeches (Virgilio Diniz)

2.1. Mr Diniz delivered a short presentation¹ on the FMLC's Public Education Function, a key aspect of the FMLC's mission as a charity.

3. Introductory remarks on Libra currency and the regulatory reaction to date (Sarah Lewis)

3.1. Ms Lewis started her presentation stating that in June 2019, Facebook released a white paper outlining its aims for a crypto-currency, "Libra", which aspires to widen access to financial services, via the Facebook platform. It is hoped that it will function as a global "stable-coin" backed by a basket of real assets chosen with a view to minimising volatility. The exchange rate for Libra would be thus based on the variation of the whole basket of currencies. Ms Lewis noted that Libra is intended to be an open source decentralised block-chain based cryptocurrency. The Libra block-chain uses a Byzantine Fault Tolerant ("BFT") consensus approach and aims to be pseudonymous. Libra aims to launch in 2020 under a permissioned system, and move to a permission-less system within five-years. It is anticipated that there could be as many as 1.5bn users.

3.2. Ms Lewis noted users will interface with Libra through exchanges and wallets in the way usually associated with virtual currencies. There are several questions the white paper does not answer, such as, for example, whether Libra is an investment fund or a virtual currency.

3.3. Ms Lewis explained that Libra is overseen by a Swiss non-profit organisation, the Libra Association, of which there are currently 27 members (including expressions of interest). Facebook's founding members and one representative per node-operator form the Libra Association Council. Facebook has announced, that while it is playing a leading role currently, once launched it will be an equal member.

3.4. The regulatory response overall is sceptical. A key concern is whether Libra coin represents a deeper systemic risk as Facebook's user base is much larger than other crypto currencies. European and other regulators have expressed concerns about money laundering controls,

¹ Please see Appendix I

privacy and consumer protection, the impact on fiat currencies, and the growing market power of ‘BigTech’. Also of concern is that it could potentially constitute a platform whereby countries and individuals who are subject to government sanctions could bypass controls to transfer money. The U.S. Securities and Exchange Commission (“SEC”) is considering if Libra is an exchange-traded fund and consequently falls under its oversight. Congressional hearings have raised concerns about Libra.

- 3.5. Members discussed the categorisation of Libra. Under the Howey test it is arguably not a security, but more similar to Ether or Bitcoin. However, it is not truly decentralised like these virtual currencies. Alibaba or WeChat potentially have a similar offering in terms of social media with payments attached, however they are not pseudonymous or block-chain based.
- 3.6. Ms. Lewis outlined Facebook’s response to regulatory concerns which is that the Libra Association would take an active role in developing and performing policies and procedures with the aim at complying with anti-money laundering and other regulations.
- 3.7. The Libra white paper is light on details. There remain many questions apart from the issues of categorisation and oversight, for example tax issues.

4. Machine learning/big data and the regulation of consumer credit markets (Nikita Aggarwal);

- 4.1. Ms. Aggarwal started her introductory remarks pointing out how a social credit score mechanism might have an impact on the credit markets and how regulation could function in managing credit score. She differentiated a putative Western model from Chinese social credit scoring. Financial credit history is considered in traditional credit scores, but in non-traditional approaches to other, such as rental payments, utilities and social data can be used. She highlighted that the use of more sophisticated data could be achieved through the development of machine learning, whereby there will be more efficient gains than using only traditional data. This represents possible opportunity for consumer credit markets.
- 4.2. Ms. Aggarwal stressed that the use of machine learning in the credit score mechanism could also open new avenues for discrimination, in the sense that there is no guarantee that service providers would offer proper services to help consumers to choose the best product. She added that the current U.K. system is a principle-based and outcome-based, but manipulation still takes place. Therefore, strengthening statistic modelling should be desirable to refine impact assessment and credit scoring. Ms. Aggarwal then raised a question whether the Financial Conduct Authority (“FCA”) might consider using machine

learning to monitor market behaviour, considering the interaction in between data protection laws and financial rules. She stressed that data protection concerns and human rights issues arise within the current system and are being addressed.

5. Any other business

5.1. No other business was discussed.

The FMLC's Public Education Function: Speeches



Virgilio Diniz, Project Manager

Registered Charity Number: 1164902.

"FMLC" and "The Financial Markets Law Committee" are terms used to describe a committee appointed by **Financial Markets Law Committee**, a limited company.
Registered office: 8 Lothbury, London, EC2R 7HH. Registered in England and Wales. Company Registration Number: 8733443.

The FMLC's charitable remit

According to the charitable 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).

Reduced legal uncertainty and risk is in the public good; the *radar* and *research* functions are somewhat self-explanatory in this regard. The *public education* function is a key aspect of the FMLC's status as a charity, and is addressed in the following ways:

- All FMLC papers, presentations/speeches and correspondence are freely available via the FMLC website.
- The FMLC seeks to raise the profile of its research with those who are best positioned to implement solutions. This is achieved primarily through correspondence: the FMLC maintains active correspondence with regulatory and legislative groups around the world, particularly HM Treasury and the European Commission.
- Most FMLC events (with the exception of Patrons' events) are free to attend by members of the public.
- The FMLC also acts as a bridge to the judiciary, a task it carries out primarily by organising seminars to brief senior members of the judiciary on aspects of wholesale financial markets practice.

The Public Education Function

- Along with publications and events, the FMLC Secretariat furthers the Committee's education function by giving speeches about legal developments and issues of legal uncertainty in the financial markets.
- These speaking engagements may be at high-profile events or at a smaller gathering of an interested audience at a stakeholder firm.
- Members of the Secretariat have presented to audiences, within law firms for example, which are interested in learning about current issues facing the financial markets.
- The FMLC used to be CPD-qualified and such talks presented excellent training opportunities.
- Example of topics on which the Secretariat has presented are set out in slides below.

Brexit, FinTech and FinTech Regulation After Brexit

Transitional Period: “Fourth” Country

- Another uncertainty arising in the context of a transition period will be the U.K.’s status during the period as a result of the U.K.’s status during the period as a Member State.
- While the U.K. will continue to be considered a Member State for the purposes of intra-E.U. business, such a status will not legally continue to be party to the E.U.’s internal market rules.
- For example, U.K. CCPs may not automatically be substituted compliance concessions awarded by the CFTC.
- It will be necessary to start from scratch for authorities to negotiate bilateral mutual recognition agreements with each Third Country jurisdiction in order to maintain access to its markets.

FinTech Today

- At the end of 2018, Bloomberg reported that there were over 2000 types of cryptocurrencies in use.
- According to a KPMG report, there are over 2000 types of cryptocurrencies in use.
- In March 2019, the Bank of England announced a trial of cross-border central bank digital currencies.
- On 28 June 2019, Facebook announced its “stable global cryptocurrency” – Libra, which will be backed by a basket of fiat currencies.
- Blockchain venture capital funds have increased significantly.

Post-Brexit U.K. Fintech Regulation

- HMT Consultation on Transposition of 5th Money Laundering Directive
 - Expands regulatory perimeter to include virtual currencies and custodian wallet providers
- FCA Cryptoassets Taskforce Report
 - Sets out measures that the U.K. authorities intend to take regarding cryptoassets, including regulating financial instruments that reference cryptoassets and consulting on extending the regulatory perimeter for ICOs
- FCA’s Feedback Statement (FS17/4) on its Discussion Paper (DP17/3) on DLT
 - Suggests current rules are flexible enough to accommodate use of DLT and that the FCA will continue to monitor DLT-related market developments
- FCA granting e-money licences
 - The FCA granted its first e-money licence to Coinbase in March 2018
- FCA Guidance (FG16/5) for firms outsourcing to the “cloud”
 - Lists areas of guidance that firms should consider when outsourcing to the cloud and other third-party IT services, including legal and regulatory concerns and effective access to data.

IBOR Transition (at the P.R.I.M.E Finance Conference 2019)

F
M
L
C

SONIA (OIS)

- The definition of SONIA has two elements:
 - (i) Statement of underlying interest
SONIA is a measure of the rate at which int wholesale funds in circumstances where credit
 - (ii) Statement of methodology
On each London business day, SONIA is measured four decimal places, of interest rates paid on eligible transactions.

Euro Rates

EURIBOR is the rate at which Euro interbank term deposits are offered by one prime bank to another prime bank within the EMU zone, and is calculated at 11:00 a.m. (CET) for spot value (T+2)

EONIA is a rate which represents the rates at which banks of sound financial standing in the European Union and European Free Trade Area (EFTA) lend funds in the overnight interbank money markets in Euro

ESTER is a rate which reflects the wholesale euro unsecured overnight borrowing costs of euro area banks. The rate is published for each TARGET2 business day based on transactions conducted and settled on the previous day (reporting date T) with a maturity date of T+1 and which are deemed to be executed at arm's length

- Eligible transactions are:
 - reported to the Bank's Sterling Money Market daily data reported to the Bank's Reporting Instructions for Foreign Exchange
 - the effective version of the 'Reporting Instructions for Foreign Exchange'
 - unsecured and of one business day maturity;
 - executed between 00:00 hours and 18:00 hours UK time and greater than or equal to £25 million in value.

Brexit and finance: the legal framework

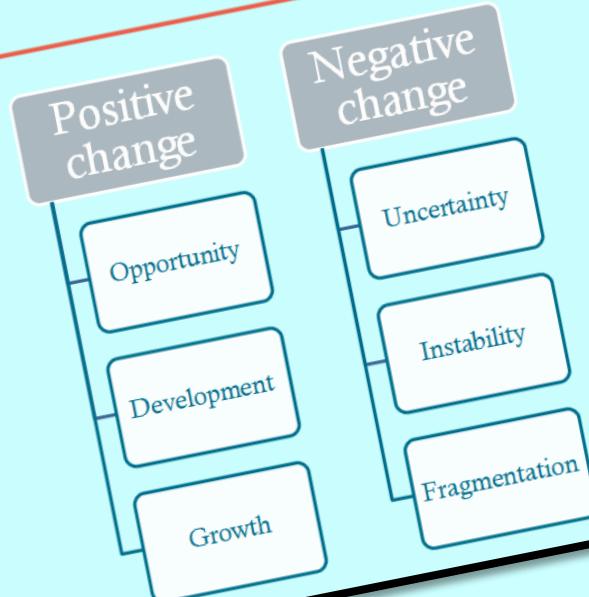
two faces of a Brexit future:

Covering note on the Financial Regulators' Powers (Technical Standards) (Amendment etc.) (EU Exit) Regulations 2018

5 Following this model will mean that EU 'Level 1' legislation (which was developed by the European Commission and negotiated through the Council and European Parliament) and 'Level 2' legislation (apart from BTS and certain other technical elements of Level 2), will become the responsibility of the UK Parliament. This body of EU legislation includes provisions which set the policy direction for financial services, so it is appropriate that responsibility for deciding how deficiencies are fixed in this legislation should rest with Parliament. HM Treasury will propose amendments to this legislation, using the powers under the EUWB, ensuring that Parliament is able to scrutinise all of the changes. It is expected that the majority of the statutory instruments needed to correct deficiencies in this legislation will be laid under the affirmative procedure.

6 For certain EU 'Level 2' technical rules, known as Binding Technical Standards (BTS), HM Treasury proposes to transfer ongoing responsibility from the European Supervisory Authorities to the UK financial regulators – the Bank of England, the PRA, the FCA and the Payment Systems Regulator (PSR). BTS, running to several thousand pages, do not set overall policy direction but fill out the technical detail of how the requirements set at Level 1 are to be met. Having played an important role in the EU to develop these standards, through their membership of the Boards and working groups of the European Supervisory Authorities, UK regulators have the necessary expertise and resource to maintain them after the UK's exit from the EU. This allocation of responsibility would be consistent with the general rule-making responsibilities already delegated to the FCA and PRA by Parliament under FSMA.

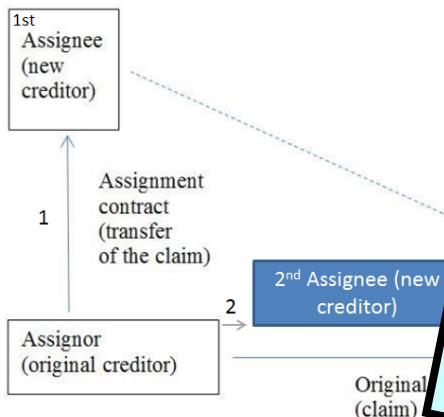
7 As HM Treasury proposes to transfer ongoing responsibility for BTS to the UK regulators, it also makes sense that the regulators perform the task of making corrections to deficiencies in existing BTS so that these rules operate effectively in the UK at exit. HM Treasury therefore proposes to delegate to UK financial regulators the power to correct deficiencies in BTS arising from EU withdrawal.



Conflicts of laws on securities and claims: collateralisation

F
M
L
C

Collateralisation and the assessment of claims



Collateralisation and the assignment of claims

- The Commission proposal insures that retail deposits will be protected against banks by natural person depositors under the law of the underlying claim.
 - This is the correct rule: it is based on the principle that a deposit by a natural person, who is a habitual resident, is a personal contract.
 - Situations in which individual rights may be affected include the taking of security in respect of a relationship, the assigning of association to a company on the bank account from one spouse. In such cases, the relevant matters are excluded from the protection. It may be that only the residence, it may be that only the generate a legally certain result.

Collateralisation

 - Further, with regard to bank accounts, if a bank is able to take a charge over their assets, it will be able to take the assigned claim and irrespective of the place of habitual residence.
 - The question arose for consideration in *Bankers Services Ltd [1987] Ch 150*, whether a bank should take a charge in these circumstances.

Collateralisation and the assignment of claims

- Further, with regard to bank accounts in general, it is often argued that banks should be able to take a charge over their own indebtedness *vis à vis* their clients under the law of the assigned claim and irrespective of any rule to the contrary in the law of the latter's habitual residence.
 - The question arose for consideration in the U.K. courts in two cases: *In re Charge Card Services Ltd* [1987] Ch 150, where it was held to be "conceptually impossible" that banks should take a charge in these circumstances, and *Re Bank of Credit and Commerce International SA (No 8)* [1998] AC 214, where the House of Lords settled the question and upheld the charge. In between these case decisions, legislation was enacted in several jurisdictions with common law influence (including the Cayman Islands, Bermuda, Singapore and Hong Kong) providing for the validity and enforceability of charges of this kind, which were common at the time and continue to be prevalent as a means of taking security today.

Summary and Conclusion

- The Secretariat is happy to visit your organisation and introduce legal uncertainties in a relevant area of the financial markets.
- This helps us get reach a wider audience of stakeholders, learn about the questions occupying their time and fulfil our public education.
- If you are interested, get in touch with Debbie Hayes at: secretarial@fmlc.org or with Venessa Parekh at: research@fmlc.org