Financial Services Compliance 2021

Contributing editor
Zachary J Zweihorn
Davis Polk & Wardwell LLP

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Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Egypt, Indonesia, Ireland and Italy.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Zachary J Zweihorn of Davis Polk & Wardwell LLP, for his assistance with this volume.

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Contents

Introduction 3
Zachary J Zweihorn
Davis Polk & Wardwell LLP

Australia 5
Peter Reeves, Simon Barnett and Catherine Collins
Gilbert + Tobin

Brazil 14
José Luiz Homem de Mello and Ana Clara Pessoa Mello de L Castro
Pinheiro Neto Advogados

Canada 22
Michael Garellek
Gowling WLG

Egypt 31
Dina Salah
Soliman, Hashish & Partners

Hong Kong 35
Joyce Chow and Karen Chan
Davis Polk & Wardwell LLP

Indonesia 43
Elsie F Hakim, Giffy Pardede and Monic Nisa Devina
ABNR

Ireland 49
Keith Waine and Laura Twomey
Dillon Eustace

Italy 56
Marco Penna, Giovanna Tassitano and Marylisa Izzo
Legance – Avvocati Associati

Japan 61
Kunihiko Morishita, Takaharu Totsuka, Daisuke Tanimoto and Takahiko Yamada
Anderson Mōri & Tomotsune

Netherlands 68
Tim Alferink and Martijn Stolze
Baker McKenzie

Portugal 74
Miguel Stokes and Bruno Silva Palhão
Uría Menéndez

Spain 79
Isabel Aguilar Alonso
Uría Menéndez

Switzerland 84
François Rayroux, Patrick Schleiffer, Laurence Vogt Scholler, Patrick Schärli and Sarah Bechaalany
Lenz & Staehelin

United Kingdom 90
Jennifer Duffy, Mark Chalmers and Simon Witty
Davis Polk & Wardwell LLP

United States 95
Annette L Nazareth, Mark A Sater and Zachary J Zweihorn
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Introduction

Zachary J Zweihorn

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It is an understatement to say that the regulation of financial services is constantly evolving. Policymakers and financial regulators must continually adopt new laws and regulations and take other actions in response to financial crises and other market events. The year 2020 was no exception. Understandably, the primary focus of financial regulators over the course of 2020 was responding to the economic contraction and market stresses caused by the covid-19 global pandemic.

Regulators across the globe took a range of actions to stimulate their local economies and to otherwise mitigate the financial impact resulting from the pandemic. In the United States, for example, the US Congress passed the Coronavirus Aid, Relief and Economic Security Act to provide over US$2 trillion to support the economy, households, businesses and other entities. The Federal Reserve also lowered benchmark interest rates and established a number of emergency credit facilities to provide liquidity to primary dealers, depository institutions and other entities.

In addition, regulators, acting at a national level and through international bodies, such as the Financial Stability Board (FSB) and the International Organization of Securities Commissions (IOSCO), engaged in efforts to analyse weaknesses in the financial markets highlighted by the global pandemic and to consider possible policy responses. For example, the FSB submitted a report to the G20 analysing the financial stability risks relating to covid-19 and the international policy responses. IOSCO reprioritised its work program to address the impact of covid-19 and, among other things, published a report on the impact of covid-19 on retail market conduct.

These studies and the reforms that are implemented in response will likely shape the financial regulatory landscape for years to come. One area in particular that is likely to see regulatory reform is with respect to money market funds, as discussed further below.

In addition to responding to covid-19, regulators have also been grappling with a number of other emerging regulatory issues, including relating to shadow banking, digital assets and other new technologies, and interest rate benchmark reform.

Money market fund reform

One market segment that exhibited significant stresses as a result of covid-19 was the money market fund sector (in general, investment funds that provide daily liquidity, limited principal volatility and payment of short-term market returns). The uncertainty caused by the pandemic led investors to shift their risk preferences towards cash and other highly liquid instruments, resulting in significant outflows from money market funds holding non-public debt. In addition to providing a cash management vehicle for retail and institutional investors, money market funds serve as an important source of short-term financing for corporates, financial institutions and governments. As a result, the outflows from these funds contributed to stress in short-term funding markets generally.

In the United States, the outflows continued until the Federal Reserve established the Money Market Mutual Fund Liquidity Facility and other facilities to support short-term funding markets generally and money market funds in particular. Regulatory authorities in other jurisdictions took similar actions. Although authorities were able to respond to the immediate concerns, these events highlighted a need for further analysis of the structural vulnerabilities associated with money market funds and potential regulatory reforms. To this end, IOSCO published a thematic note describing the impact on money market funds in various jurisdictions resulting from the pandemic, as well as a final report analysing the consistency in implementation of money market reforms previously recommended by IOSCO in 2012.

In the United States, the President's Working Group on Financial Markets (PWG), a group of consisting of the Secretary of the US Treasury and the Chairs of the SEC, CFTC and the Federal Reserve System, published a report outlining potential policy measures to increase the resilience of money market funds. In early 2021, the SEC followed up on the PWG report by publishing a notice requesting comments from the public on the effectiveness of implementing the policy measures described in the PWG report, which further signals that there are likely to be reforms in this area.

The impact of money market funds on short-term funding markets is one example of a broader trend that regulators have been grappling with – the continued growth of financing provided by non-bank intermediaries ('shadow banking'). This topic has been a focus of the FSB over the past several years, and was again included in the FSB's priorities for 2020. As part of its efforts in this area, the FSB publishes an annual report, which monitors and assesses the growth and risks of non-bank financial intermediation.

Digital assets and other emerging technologies

Beyond covid-19, global regulators also continued to focus on the impact of evolving technologies on financial regulation, in particular digital assets. Much of the attention was on the use of stablecoins, digital assets that are designed to maintain a stable value relative to an identified fiat currency or other asset. Supporters of stablecoins argue that they have the potential to make payments more efficient and promote financial inclusion. However, stablecoins may also introduce financial stability, integrity and other risks into the financial system, particularly if they are used across multiple jurisdictions (ie, global stablecoins).

To help address these concerns, the FSB published a final report, which sets out high-level recommendations for regulatory, supervisory and oversight responses to global stablecoin arrangements. Among other things, these recommendations include ensuring that global stablecoin arrangements have in place effective governance and risk management frameworks, robust systems for collecting, storing and safeguarding data, and appropriate recovery and resolution plans.

In the United States, the PWG also released a statement emphasising key regulatory and supervisory issues regarding stablecoins, including that stablecoin participants and arrangements must meet all applicable anti-money laundering and countering the financing of terrorism and sanctions obligations before bringing products to market.

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Another aspect of digital assets that has captured the attention of authorities is the issuance of digital currencies by central banks, to help deliver their public policy objectives. In October 2020, the Bank for International Settlements, in collaboration with a group of central banks, published a report outlining foundational principles and core features that should be established with respect to any central bank digital currency.

Regulators have also been focused on other emerging technologies. For example, IOSCO published a consultation report on the use of artificial intelligence and machine learning by market intermediaries and asset managers.

Transition from inter-bank offered rates

Another area that received significant attention is interest rate benchmark reform. With the future discontinuation of LIBOR and other inter-bank offered rates (IBORs), regulators and industry groups have engaged in efforts to help facilitate a smooth transition from IBORs to alternative reference rates. For example, the International Swaps and Derivatives Association, Inc (ISDA) published new 'fallback' provisions for derivatives that reference certain IBORs. These fallbacks provide that upon a cessation of an IBOR, the derivatives contract will be deemed to reference a fallback reference rate. In addition, ISDA published a multilateral protocol (the ISDA 2020 IBOR Fallbacks Protocol), which will allow adherents to this protocol to include the fallback provisions in legacy contracts entered into with other counterparties that choose to adhere.

In many cases, legacy derivatives transactions entered into prior to the compliance date of a particular requirement will not be subject to that requirement; however, a legacy derivative may become subject to the requirement if it is amended after the compliance date. In an effort to remove impediments to transitioning away from IBORs, various regulators have provided relief to market participants from compliance with certain requirements, such as uncleared derivative margin requirements, for derivatives that are amended to include alternative reference rates or fallback provisions. Market participants are continuing to work with regulators on other potential regulatory issues, including whether and how the large number of transition amendments will be reported to data repositories.

This edition of *Financial Services Compliance* is a compilation of the rules and approaches to financial services compliance in each of the major jurisdictions and the European Union. Our hope is that this very practical and pragmatic guide will assist lawyers, compliance professionals, boards of directors and others who represent or are engaged with globally active institutions in navigating the regulatory requirements and frameworks of multiple jurisdictions. Understanding the regulatory landscape and the differences in approaches is fundamental to successful transactions in financial commerce across borders. Each chapter of this guide has a common set of questions, allowing readers to deepen their understanding of a single jurisdiction, or to understand how any particular issue or product would be treated across a number of geographies. Importantly, the authors of each chapter are leading authorities on financial services regulation in their respective jurisdictions. Each author has practical experience in the details of his or her jurisdiction, which makes this volume important for globally active firms, regional institutions and purely national market participants.

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Hong Kong

Joyce Chow and Karen Chan

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REGULATORY FRAMEWORK

Regulatory authorities

1 What national authorities regulate the provision of financial products and services?

The Hong Kong system of financial regulation reflects a modified institutional approach, with different regulators largely responsible for the oversight of different types of financial institutions.

The two principal authorities responsible for the regulation of banking, securities and derivatives products and services are the:

- the Hong Kong Monetary Authority (HKMA), which regulates banks; and
- the Securities and Futures Commission (SFC), which regulates securities, futures and other contract markets, as well as certain entities that participate in those markets.

There is, however, increasing overlap among and between regulators, particularly as banks expand the range of securities activities in which they are engaged.

2 What activities does each national financial services authority regulate?

The HKMA oversees all aspects of authorised banking institutions within its jurisdiction, including banks, restricted licence banks (eg, merchant banks) and other deposit-taking companies. It supervises these authorised institutions on a consolidated basis, with the aim of promoting the safety and stability of the banking system, including in respect of local and overseas branches and subsidiaries. The principal areas of HKMA supervision include capital adequacy and liquidity, exposure concentration, resolution, and anti-money laundering and counter-financing of terrorism (AML/CFT) obligations (eg, customer due diligence), with different requirements applicable to locally and foreign incorporated institutions.

The SFC is responsible for the licensing (or registration) and supervision of intermediaries and individuals, including broker-dealers, advisers and funds, engaged in a wide range of securities and futures activities, including:

- dealing in securities;
- dealing in futures contracts;
- leveraged foreign exchange trading;
- advising on securities;
- advising on futures contracts;
- advising on corporate finance;
- providing automated trading services;
- securities margin financing;
- asset management; and
- providing credit rating services.

In 2020, the SFC issued guidelines for family offices intending to carry out asset management or other services in Hong Kong noting that there is no separate licensing regime in Hong Kong for family offices, and SFC regulation of such businesses remains activity-based (ie, dependent on the type of operations and activities undertaken by the family office).

The SFC is also responsible for overseeing market operators, including, among others:

- Hong Kong Exchanges and Clearing Limited (HKEx), which operates:
  - the Stock Exchange of Hong Kong (SEHK);
  - the Hong Kong Futures Exchange;
  - clearing houses; and
  - alternative trading platforms (eg, dark pools);
- overseeing takeovers and mergers of listed companies; and
- the regulation of investment products (including, from April 2019, investment products offered by intermediaries via online platforms).

For example, the SFC and the SEHK work closely together in relation to tackling backdoor listings and shell activities. Backdoor listings involve transactions or arrangements (usually involving listed shell companies) that are structured to achieve a listing of assets while circumventing the requirements that apply to a new listing applicant. Problems with such listings have received widespread attention in Hong Kong.

Authorised banking institutions supervised by the HKMA must register with the SFC as to regulated securities activities undertaken in Hong Kong, but the HKMA is responsible for the day-to-day oversight of any such activities performed by these authorised institutions. The precise role and responsibilities of the HKMA in respect of the securities activities of authorised institutions are set out in a series of memoranda of understanding between the HKMA and the SFC. The Secretary for Financial Services also plays a coordinating role, and helps to set policy for the securities and futures markets generally.

3 What products does each national financial services authority regulate?

As described above, the HKMA exercises comprehensive supervisory oversight over all of the activities of authorised banking institutions, rather than regulating particular types of products.

The SFC regulates licensed (or registered) institutions on the basis of the activities in which they are engaged, for example, by imposing principles-based business conduct standards. These conduct standards are applicable to all licensed and registered institutions (and individual persons), and include expectations and requirements as to the suitability of products offered or sold to third-party customers.

Through its supervisory and rule-making authority over market operators, the SFC also regulates certain financial products, including securities and futures. It thus has indirect authority over the manner in which these products are transacted, for instance, on exchange or over

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the counter. In addition, the SFC directly authorises and regulates investment products, including, among others, closed-end funds, exchange traded funds, leveraged and inverse products, pooled retirement funds, unit trusts and mutual funds, structured investment products, real estate investment trusts, unlisted shares and debentures, and open-ended fund companies.

Authorisation regime

4 What is the registration or authorisation regime applicable to financial services firms and authorised individuals associated with those firms? When is registration or authorisation necessary, and how is it effected?

As to securities and futures activity, financial services firms must be licensed by the SFC before engaging in any of the regulated activities, subject to narrow statutory exemptions. Licensing is necessary when financial services firms carry out a regulated activity, as well as when they hold themselves out as doing so. A licence must be obtained (or a relevant exemption identified) for each type of regulated activity the financial services firm intends to undertake.

Licensing is also necessary if a financial services firm actively markets to the public in Hong Kong any service that would be a regulated activity if performed in Hong Kong. This is true whether the firm is marketing its services from Hong Kong or overseas, including when it does so through a third party. For instance, a US-based asset manager soliciting clients for its US-based services in Hong Kong would need to be licensed for asset management activity in Hong Kong, even if the solicitation was undertaken through its Hong Kong-licensed subsidiary.

Individuals must also be licensed before performing a regulated activity on behalf of their licensed corporation. In addition, any executive directors (ie, senior managers) supervising a licensed corporation's regulated activities must also be licensed as 'responsible officers'.

Temporary licences are available to both firms and individuals if they will undertake regulated activity only on a short-term basis, and it is the SFC's expectation that such licences will be obtained before any regulated activity is undertaken, even in the case of day-long business meeting in Hong Kong, for instance.

To receive a licence, a firm or individual must apply to the SFC. Different requirements apply to each type of regulated activity, but at a minimum, the application process ordinarily requires the submission of extensive materials, including detailed business plans, biographies of senior employees, directors and officers, and other corporate and individual records. All licensed persons – firms or individuals – must also, at a minimum, demonstrate that they are 'fit and proper', in connection with which the SFC evaluates the applicant's financial status, qualifications, competence, honesty, fairness, reputation and character. Licensed firms must also comply with additional requirements, including financial resources rules (eg, rules relating to minimum paid-up share capital and liquid capital) and insurance rules. The application process for temporary licences is less complex, especially for individuals.

With regard to the regulation of virtual assets (eg, digital currencies, crypto assets) and the platforms on which they are traded (virtual asset services platforms or 'VASPs'), in November 2020, the SFC proposed amendments to the AML/CFT statutes that would introduce a mandatory licensing regime for VASPs. Under the proposals, all VASPs operating in Hong Kong would be required to be licensed, regardless of whether or not the virtual assets they trade fall under the definition 'securities'. This represents a change of approach from the more permissive stance announced by the SFC in 2019 (representing an 'opt-in' approach to regulation for VASPs) and is consistent with the recommendations of the Financial Action Task Force that AML/CTF obligations be imposed on VASPs. Depending on the outcome of the consultation, a legislative bill is expected to be introduced into the Hong Kong Legislative Council in 2021. In December 2020, the SFC announced that it had granted the first license to a VASP in Hong Kong (under the existing 'opt in' regime) to carry out Type 1 (dealing in securities) and Type 7 (providing automated trading services) regulated activities, subject to the requirement that the VASP in question will only serve professional investors under the close supervision of the SFC.

Banking organisations are subject to similar authorisation requirements, albeit overseen by the HKMA rather than the SFC. Authorisation is required when banking activities are undertaken in Hong Kong, and also when they are marketed to customers in Hong Kong. Hong Kong has a three-tier banking system that includes banks, restricted licence banks and deposit-taking companies. Different regulations, including different authorisation requirements, apply to locally incorporated banking organisations than to the Hong Kong branches of overseas banks. Otherwise, the application requirements are similar to those applicable to financial services firms licensed by the SFC, and banking entities seeking to engage in securities and futures activities in Hong Kong must also be licensed by the SFC.

The HKMA has also issued licences to virtual banks (ie, banks that deliver retail banking services primarily, if not entirely, through the internet or other electronic channels rather than physical branches). As of 31 January 2021, there are in total eight virtual banks licensed by the HKMA. Virtual banks will be subject to the same set of supervisory principles and key requirements as conventional banks, although some of the requirements may be adapted to suit this new business model.

Legislation

5 What statute or other legal basis is the source of each regulatory authority's jurisdiction?

The importance of financial services to Hong Kong as an international financial centre is recognised in its Basic Law, which also gives the government the authority to 'formulate monetary and financial policies, safeguard the free operation of financial business and financial markets, and regulate and supervise them in accordance with the law'.

Otherwise, the jurisdiction of both the HKMA and the SFC is proscribed by statute: the Banking Ordinance (Cap. 155) in the case of the HKMA, and the Securities and Futures Ordinance (Cap. 571) (SFO) in the case of the SFC.

These ordinances set out the supervisory, examination and enforcement powers of the HKMA and SFC, respectively, in addition to conferring upon each regulator the authority to promulgate more particularised subsidiary legislation (ie, rulemaking with the force of law) and non-binding guidance in respect of defined topics (eg, product suitability).

In relation to AML/CFT, the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (AMLO) sets out the statutory requirements relating to customer due diligence (CDD) and record-keeping for specified financial institutions, and the powers of the relevant authorities (Including the HKMA and SFC) to supervise financial institutions' compliance with the requirements.

6 What principal laws and financial service authority rules apply to the activities of financial services firms and their associated persons?

HKMA

The principal statute applicable to institutions authorised by the HKMA is the Banking Ordinance (Cap. 155).

The Banking Ordinance sets out the requirements for authorisation of financial services firms seeking to provide banking services, the HKMA's powers of direction and examination, restrictions on the ownership and management of authorised institutions, and liquidity

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and capital requirements, among others. It also authorises the promulgation by the HKMA of subsidiary legislation addressing a range of topics, from capital and liquidity requirements to disclosure rules, in more particularity.

In addition to the Banking Ordinance and associated subsidiary legislation, institutions authorised by the HKMA must also comply with the minimum expectations and standards set out in the HKMA's Supervisory Policy Manual. The Supervisory Policy Manual codifies the HKMA's supervisory policies and practices, some of which reflect requirements under the Banking Ordinance or AMLO, while others reflect industry best practices. Among the regulatory topics it addresses are corporate governance; internal controls; capital adequacy; credit, interest rate, operational and liquidity risk management; securities activities; and money laundering.

SFC

The principal statute applicable to entities and persons licensed or regulated by the SFC is the SFO. The SFO sets out the licensing requirements for entities conducting regulated activity in Hong Kong; record-keeping, reporting and disclosure requirements; and civil, criminal and disciplinary enforcement regimes in respect of market misconduct. The SFO also confers upon the SFC the authority to promulgate subsidiary legislation addressing a wide range of topics including the treatment of client monies and securities, professional investors, short positions, contract limits, price stabilisation, and investor compensation.

In the case of both the HKMA and SFC, the regulatory requirements reflected in statutes, subsidiary legislation and other binding policy statements are supplemented by a variety of codes of conduct, guidelines and circulars with varying degrees of legal effectiveness.

Scope of regulation

7 What are the main areas of regulation for each type of regulated financial services provider and product?

Institutions authorised by the HKMA are supervised on a consolidated basis. The main areas of regulation and supervision are registration; safety and soundness; capital and liquidity; internal controls and governance; business conduct; risk management (including AML/CFT), record-keeping, and reporting and disclosure. Pursuant to a memorandum of understanding (MoU) between the HKMA and SFC, the HKMA is also responsible for supervising the securities activities of HKMA-authorised institutions on a day-to-day basis, with the SFC principally responsible for enforcement action in respect of misconduct arising from such activities.

The SFC, unlike the HKMA, only regulates certain defined securities and futures activities. In respect of these activities, it regulates, inter alia, licensing requirements; business conduct (ie, the standard of care afforded customers); market conduct; internal controls, governance and supervision (including AML/CFT); the treatment of client securities and monies; record-keeping, reporting and disclosure obligations; the timing and format of contract notes; and various activity restrictions.

Additional requirements

8 What additional requirements apply to financial services firms and authorised persons, such as those imposed by self-regulatory bodies, designated professional bodies or other financial services organisations?

The SFC is responsible for licensing market operators, most notably the SEHK, the Hong Kong Futures Exchange and their associated clearing entities. These market operators act as self-regulatory bodies, but also as frontline regulators. Any person seeking to trade or clear through their facilities must comply with the policies, rules and procedures promulgated by each operator (and approved by the SFC). In the case of the SEHK, for instance, these rules govern admissible order types and sizes; trading hours; closing mechanisms; trade reporting; trading misconduct; maximum allowable position and lot sizes; the trading engine; and short selling restrictions, among other topics. Importantly, the SEHK is also the frontline regulator in respect of listing and listing applications.

ENFORCEMENT

Investigatory powers

9 What powers do national financial services authorities have to examine and investigate compliance? What enforcement powers do they have for compliance breaches? How is compliance examined and enforced in practice?

Both the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) have the power to conduct on-site inspections and examinations of the financial services firms they regulate, and to compel the production of certain documents. Both regulators also conduct off-site surveillance – the HKMA of the financial condition of the institutions it authorises, and the SFC of market conditions and trading activity.

In connection with these powers of inspection and surveillance, both regulators are also given the authority to conduct investigations, which can lead to disciplinary, civil or criminal enforcement actions.

Disciplinary powers

10 What are the powers of national financial services authorities to discipline or punish infractions? Which other bodies are responsible for criminal enforcement relating to compliance violations?

Both the HKMA and the SFC are authorised to take disciplinary or civil enforcement action (subject to the approval of the Department of Justice) in connection with regulatory breaches. A wide range of sanctions is available even in the disciplinary context, including licence revocation or suspension, fines and public reprimands, among others. In many cases, the HKMA and the SFC also require the entities or persons responsible for regulatory violations to strengthen and enhance internal controls and governance. In the civil context, the SFC can also petition the court for winding-up or bankruptcy orders, restoration orders, declarations that securities transactions are void, or for receivership. In addition, the courts and relevant tribunals can require disgorgement, impose financial penalties and enforce activity restrictions and prohibitions on future conduct.

The HKMA and SFC can also seek criminal prosecution in connection with certain regulatory breaches. The SFC can prosecute 'summary offences' on its own, but must refer any indictable offences to the Department of Justice. The HKMA must refer all potential offences to the Department of Justice for prosecution.

The Stock Exchange of Hong Kong (SEHK) also has powers to discipline listed companies and their directors or senior management. In August 2020 the SEHK announced proposals that would increase its disciplinary powers – the first such change to its disciplinary powers since they were first put in place in 1993.

The Memorandum of Understanding entered into between the Independent Commission Against Corruption and the SFC in August 2019 also formalises and enhances collaboration between the two bodies in combating corrupt and illicit activities relating to Hong Kong's securities and futures industry.

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Tribunals

11 | What tribunals adjudicate financial services criminal and civil infractions?

Hong Kong has a number of specialised tribunals responsible for the adjudication of disciplinary and civil financial services infractions. In most cases, the regulatory authorities are also able to pursue civil enforcement actions in the Hong Kong courts.

SFC disciplinary decisions, for instance, are subject to appeal to the Securities and Futures Appeals Tribunal, where a full de novo review of the disciplinary proceedings is conducted by a three-member panel consisting of a chairman and two lay members. Final orders entered by the Securities and Futures Appeals Tribunal can be registered in or appealed to the Hong Kong courts.

Similarly, civil breaches of market misconduct provisions are heard by the Market Misconduct Tribunal, a three-member panel (one judge and two lay members) in which the SFC acts as the presenting officer. The Tribunal can issue injunctions, order disgorgement, or impose a prohibition on dealing in securities, taking management roles in listed companies or engaging in future misconduct. Subsequent violations of its orders are punishable by imprisonment and fines.

Otherwise, civil actions are dealt with by the Hong Kong courts.

Penalties

12 | What are typical sanctions imposed against firms and individuals for violations? Are settlements common?

In the disciplinary setting, the most common sanctions are fines (ordinarily three times the profit earned or loss avoided), public reprimands and partial licence suspensions. Penalties can range from incidental amounts to well over US$50 million, depending on the severity and scope of the relevant violations. Settlement of disciplinary actions is relatively common, but the regulators nearly always require some form of public reprimand.

For civil enforcement actions, the full range of economic and equitable sanctions are available, with disgorgement and prohibitions on future activity (eg, acting as the director of a listed company) being particularly common. Settlements of civil actions are also quite common, although statistics as to the rate of settlement are not publicly available.

COMPLIANCE PROGRAMMES

Programme requirements

13 | What requirements exist concerning the nature and content of compliance and supervisory programmes for each type of regulated entity?

For financial services firms engaged in securities and futures activity, the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) of the Securities and Futures Commission (SFC) enshrines compliance as one of its nine general principles, and sets out numerous principle-based requirements in respect of internal controls, IT infrastructure and trading systems, the disclosure of firm financials, the handling of client assets, and compliance obligations. Other relevant subsidiary rules and regulations include the Securities and Futures (Accounts and Audit) Rules, the Guidelines on Anti-Money Laundering and Counter-Financing of Terrorism, and the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC.

The HKMA's Supervisory Policy Manual also sets out detailed guidance as to the compliance programmes expected of authorised banking institutions, the principal focus of which is risk management. The Supervisory Policy Manual also includes a Code of Conduct, which sets out the standards of business conduct and competence expected of authorised institutions and their employees.

Gatekeepers

14 | How important are gatekeepers in the regulatory structure?

Gatekeepers perform crucial functions within Hong Kong financial services firms. For firms engaged in regulated securities and futures activities, the role of gatekeepers is governed by the Securities and Futures Ordinance (Cap. 571) (SFO), its subsidiary rules and regulations, and codes and guidelines issued by the SFC. Under the SFO, firms engaged in regulated securities and futures activities in Hong Kong must have at least one 'responsible officer' for each regulated activity they are licensed to conduct. As recent cases have shown, responsible officers of licensed corporations are expected to actively supervise the functions they oversee and to bear primary responsibility for compliance, including potentially being subject to disciplinary penalties for compliance failures. This expectation is also codified in the Code of Conduct applicable to all licensed entities.

Licensed corporations are also subject to the 'managers-in-charge' regime, which aims to more clearly define who should be regarded as senior management of licensed corporations, and enhance individual accountability. The SFC has identified eight core functions of licensed corporations and requires licensed corporations to designate a manager-in-charge for each. Among the core functions are compliance (including the Chief Compliance Officer/CCO); AML/CFT; finance and accounting; risk management; and operational control and review (including the head of Internal Audit). The managers-in-charge overseeing these gate-keeping functions are subject to SFC's disciplinary powers, even if they are not themselves licensed persons. This means that traditional compliance, back-office and middle-office functions are brought within the scope of the SFC's authority.

These requirements also apply to banking organisations authorised by the HKMA, but registered with the SFC to conduct securities and futures activities. Otherwise, the HKMA takes a more traditional approach to the role of gatekeepers and corporate governance, largely relying on directors and senior officers to manage risk and ensure compliance. The HKMA's Supervisory Policy Manual does, however, set out detailed and extensive guidance as to the role of the internal audit function, including the expectation that authorised institutions will, in most cases, have an audit committee and that the internal audit function will reflect the size, scope and complexity of an authorised institution's business and operations. With respect to risk management and compliance, it is expected that there will be separate, designated risk and compliance officers, with the board of directors principally responsible for ensuring that these functions are adequately resourced.

Directors' duties and liability

15 | What are the duties of directors and senior managers, and what standard of care applies to the boards of directors and senior managers of financial services firms?

Common law directors' duties apply to the boards of directors of financial services firms in Hong Kong. These include the duties to:

- act in good faith for the benefit of the company as a whole;
- exercise power solely for proper purposes;
- exercise independent judgement and refrain from delegation without proper authorisation;
- exercise care, skill and diligence;
- avoid conflicts of interest or abuses of position;
- avoid unauthorised use of firm property or information; and
- maintain proper accounting records.

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The statutory standard of care applicable to directors is set out in the Companies Ordinance (Cap. 622). This statute expressly displaces the common law standard of care. In determining whether a director has breached his or her duties, courts in Hong Kong will apply a mixed subjective and objective test, comparing the conduct of the director to that of a 'reasonably diligent person' having the general knowledge, skill and experience reasonably expected of a person in the director's position (the objective component) and the knowledge, skill and experience that the specific director actually possesses (the subjective component).

Generally, directors of financial services firms should also bear in mind the need for management to instil a strong compliance 'tone from the top'. This is especially important in light of heightened regulatory focus on individual and senior management accountability. In May 2017, the SFC published a reminder of steps that directors may take to minimise the risk of corporate misconduct and promote a culture of good corporate governance. These include the following:

- Leading by example, directors are expected to regularly discuss governance-related matters, including by actively consulting senior management regarding observed issues within the firm, and to ensure effective channels for the escalation of concerns and suggestions of improvements.
- In order to promote timely identification of issues, directors should demonstrate genuine interest in the firm's affairs, evidenced by attendance at board meetings and obtaining updates on management accounts and corporate performance.
- In matters where personal conflicts of interest arise, directors should abstain from involvement.
- On a firm-wide level, directors should ensure the implementation of effective internal controls and whistle-blowing procedures. Systems of checks and balances should be in place to prevent policies from being overridden without due cause or accountability.

In July 2019, the SFC issued a reminder to directors and advisers of Hong Kong-listed issuers about their statutory and other legal duties they owe when evaluating or approving the acquisition or disposal of a company or business. The SFC referenced this in a February 2020 regulatory bulletin, highlighting its ongoing concern regarding directors' duties in the context of valuations in corporate transactions. It also gave examples of recurring types of misconduct which they have seen arise in that context, including (1) the lack of independent judgement and accountability, (2) proper investigation and due diligence, and (3) suspicious connected parties (eg, undisclosed relationship or arrangement among purported independent third parties).

16 When are directors and senior managers typically held individually accountable for the activities of financial services firms?

Directors may be held individually accountable for the activities of financial services firms as a result of regulatory breaches. For instance, the SFO empowers the SFC to seek injunctive relief and other orders on behalf of investors against persons who contravene (or aid, abet, induce, or are involved in the contravention of) any provision of the SFO. The SFO also authorises civil actions against directors who fail to take reasonable measures to establish safeguards against market misconduct. Directors of licensed corporations who are also responsible officers or managers-in-charge are also subject to the SFC's disciplinary powers if found liable for the misconduct of financial services firms.

Recent enforcement cases reflect Hong Kong's regulatory focus on director and senior management accountability for the activities of financial services firms, with the SFC bringing civil proceedings against individual directors for, among other things, failing to act in a company's best interest in connection with the late disclosure of inside information. These cases serve as reminders of directors' personal accountability to their corporations, and of directors' responsibilities to stay informed and alert to governance or compliance issues within their firms.

Private rights of action

17 Do private rights of action apply to violations of national financial services authority rules and regulations?

Private rights of actions for regulatory violations are available in only very limited circumstances. Such actions would be relevant for individuals who suffer pecuniary loss as a result of another person committing the market misconduct offences set out in the SFO. These offences include:

- insider dealing;
- false trading;
- price rigging;
- disclosure of information about prohibited transactions;
- disclosure of false or misleading information inducing transactions; and
- stock market manipulation.

They also include the offences of:

- use of fraudulent or deceptive devices in securities, futures contracts or leveraged foreign exchange trading;
- disclosure of false or misleading information inducing transactions in leveraged foreign exchange trading; and
- falsely representing dealings in futures contracts on behalf of others.

Persons found liable in connection with private rights of action brought pursuant to these provisions are required to pay damages if it is 'fair, just and reasonable' in the circumstances. Courts may also impose injunctive relief in addition to or in lieu of orders for damages. Potential defendants under these provisions are not limited to persons directly perpetrating a market misconduct offence. Investors also may seek to recover from persons who knowingly assist or connive with others in the perpetration of market misconduct. Officers of corporations also may be named as defendants if market misconduct was perpetrated by the corporation with the officer's consent or connivance. 'Officers' is widely defined in the SFO: directors, managers or secretaries, or any other person involved in the management of a corporation, are all deemed 'officers of a corporation'.

Standard of care for customers

18 What is the standard of care that applies to each type of financial services firm and authorised person when dealing with retail customers?

In Hong Kong, the relationship between retail customers and financial institutions is principally a matter of contract, as applied within the context of the common law duties of banks.

In addition, financial services firms licensed or regulated by the SFC must, as a condition of their licences, meet minimum, principles-based regulatory standards governing the treatment of customers which are principally set out in the SFC's Code of Conduct. The Code of Conduct requires licensed entities to act honestly, fairly and diligently, and in the best interests of their clients; to obtain adequate information about the financial situation, investment experience and objectives of clients; to make adequate disclosures of relevant information to clients; and to properly account for and safeguard client assets. The Code of Conduct also elaborates more particularised minimum requirements in respect of, among other things, the content of client agreements and the principles of prompt and best execution.

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Banks authorised by the HKMA are expected to comply with the recommended practices prescribed in the Code of Banking Practice, which was promulgated by industry associations, but endorsed by the HKMA. The Code of Banking Practice, although not binding or a condition of authorisation, sets out similar, albeit more particularised expectations for the treatment of banking customers. These are set out by reference to specific banking activities, including account management, card services, payment services, and electronic banking services, among others. These expectations reflect a set of general principles announced in the Code, among which are the equitable and fair treatment of customers, with special attention given to the needs of vulnerable groups.

19 | Does the standard of care differ based on the sophistication of the customer or counterparty?

In respect of securities and futures activity, including when such activity is performed by banks, the standard of care owed to customers varies based on the sophistication of the customer (ie, their net worth and investment experience).

Under the SFO and related guidance promulgated by the SFC, certain customers may be classified as 'professional investors'. In such cases, certain regulatory requirements are relaxed, including those pertaining to obtaining information about a customer's financial condition, experience and objectives; the minimum contents of client agreements; the suitability of investment products; and the type of transaction-related information that must be disclosed to clients.

The HKMA also recognises certain categories of customers (eg, private banking customers) for which suitability and other requirements are reduced. In respect of banking activity, however, the standard of care does not vary based on customer sophistication, aside from the expectation elaborated in the Code of Banking Practice that banks should devote special attention to vulnerable populations (eg, the elderly).

Rule making

20 | How are rules that affect the financial services industry adopted? Is there a consultation process?

With certain exceptions, all subsidiary legislation in Hong Kong ordinarily must go through a process of consultation prior to adoption. This is true for subsidiary legislation adopted by both the SFC and the HKMA (and in some cases, the regulatory bodies are also required to consult with each other). Subsidiary legislation refers to those rules and guidelines promulgated pursuant to express authority in the relevant governing statutes (ie, the SFO and Banking Ordinance).

The consultation process for subsidiary legislation involves the circulation of proposed rules for public consideration, the opportunity for public comment, the circulation of consultation conclusions setting out any public comments received, regulator responses to these comments (as well as any new amendments that substantively differ from the original draft), and publication of the final rules for adoption.

Both the HKMA and SFC also regularly publish circulars and other guidance in which they set out their interpretations of requirements set out in statute or subsidiary legislation. No consultation ordinarily is undertaken in connection with such interpretive guidance as it does not have the force of law.

CROSS-BORDER ISSUES

Cross-border regulation

21 | How do national financial services authorities approach cross-border issues?

Hong Kong largely takes a territorial approach to the regulation of its securities and futures markets. Financial services firms must be licensed by the Securities and Futures Commission (SFC) to conduct regulated securities and futures activities whenever they conduct those activities in Hong Kong, as well as when they actively market to the public in Hong Kong any service that, if performed in Hong Kong, would be a regulated activity. This is true whether the firm is marketing its services from Hong Kong or abroad, including when it does so through a third party (eg, a subsidiary or affiliate). Even when such regulated activity, or the marketing of regulated activity, is conducted in Hong Kong on a temporary or short-term basis only (eg, a one-off meeting with a brokerage client), a temporary licence is required.

Banking organisations authorised in Hong Kong are also subject to regulation in respect of their overseas activity, including the powers of inspection of the Hong Kong Monetary Authority (HKMA). They cannot open overseas branches (or acquire overseas banks) without the approval of the HKMA, and must regularly disclose to the HKMA the assets and liabilities of their overseas entities. The HKMA frequently communicates with overseas counterparts and can disclose information about the operations of institutions authorised in Hong Kong to overseas regulators, as long as there are adequate privacy measures in place. The HKMA also looks to the home regulators of banking organisations incorporated overseas in determining whether to authorise them to conduct banking activity in Hong Kong. Such organisations can only be authorised in Hong Kong if the HKMA is satisfied that they are adequately supervised by their home banking regulator. Without authorisation, overseas banks cannot engage in any banking business, although they can open local representative offices to liaise with local customers.

The SFC and HKMA also both cooperate extensively with international regulators, especially Mainland regulators.

- For example, the SFC and the China Securities Regulatory Commission (CSRC) hold regular meetings to discuss a range of matters concerning cross-boundary enforcement co-operation. In July 2019, the Ministry of Finance of the People's Republic of China (MOF), the CSRC and the SFC entered into a tripartite Memorandum of Understanding (MoU) on access to audit working papers for Hong Kong-listed Mainland companies, thus facilitating the SFC's access to audit working papers when conducting investigations into Mainland-based issuers or listed companies.
- The HKMA has signed MoUs with the China Banking and Insurance Regulatory Commission to enhance the exchange of supervisory information and cooperation, in addition to various other collaborative initiatives with the People's Bank of China, including those relating to mutual bond market access between Hong Kong and Mainland China (Bond Connect).

The SFC has MoUs with Switzerland, the United States, Singapore and Japan to facilitate varying degrees of mutual assistance on a cross-border basis and frequently makes or receives requests for assistance from regulators globally. The HKMA has similar cooperative arrangements with foreign jurisdictions, including with Australia, Canada, the mainland China, France, Germany, India, Japan, the United Kingdom and the United States.

One potential exception to this territorial approach is the catchall fraud provision of the SFO, modelled on Rule 10b-5 in the United States, which the SFC has previously used to target insider dealing in Taiwan

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in securities listed on the Taiwan Stock Exchange. Importantly, significant elements of the fraudulent scheme were devised in Hong Kong, but this enforcement action nevertheless shows that the SFC will use its ostensibly territorial jurisdiction to reach conduct that principally occurs offshore, especially where it has effects on Hong Kong's markets and market participants.

Hong Kong also takes a largely territorial approach to banking regulations, although the HKMA frequently communicates with overseas counterparts and can disclose information about the operations of institutions authorised in Hong Kong to overseas regulators, as long as there are adequate privacy measures in place. The HKMA also looks to the home regulators of banking organisations incorporated overseas in determining whether to authorise them to conduct banking activity in Hong Kong. Such organisations can only be authorised in Hong Kong if the HKMA is satisfied that they are adequately supervised by their home banking regulator. Without authorisation, overseas banks cannot engage in any banking business, although they can open local representative offices to liaise with local customers.

International standards

22 What role does international standard setting play in the rules and standards implemented in your jurisdiction?

Both regulators are active participants in the Financial Stability Board (FSB), an international body that monitors and makes recommendations about the global financial system with a view to reducing vulnerability and safeguarding the smooth functioning of financial markets through enhanced information exchange and cooperation in financial supervision and surveillance. Hong Kong's inclusion in the FSB is a recognition of its status as a systemically important financial centre.

In July 2019, the HKMA implemented the Banking (Exposure Limits) Rules which aim to implement the Basel Committee's large exposures standards (introduced in 2014) and also update other exposure limits to keep pace with market developments and contemporary risk management techniques.

In the anti-money laundering and counter-financing of terrorism (AML/CFT) sector, the SFC and HKMA both work to ensure that the international standards and guidance promulgated by the Financial Action Task Force (FATF) are adequately reflected in Hong Kong's regulatory and compliance framework. In September 2019, FATF announced the results of its recent Mutual Evaluation Report of Hong Kong (FATF Report). The FATF report assessed Hong Kong's AML/CFT regime to be compliant and effective overall (scoring in the top 25 per cent of FATF members globally), and confirmed that Hong Kong has a strong legal foundation and effective system for combating money laundering and terrorist financing.

The FATF Report made a number of recommendations for how Hong Kong could improve its AML/CFT framework. In September 2020, the SFC launched a consultation on proposals to amend its AML/CFT guidelines in line with FATF's recommendations, including proposals to incorporate FATF's recent guidance for adopting a risk-based approach in the securities sector.

UPDATE AND TRENDS

Key developments of the past year

23 Are there any other current developments or emerging trends that should be noted?

The Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA) both continued to focus on emerging technologies in 2020. In particular, the SFC and the HKMA introduced initiatives focusing on cyber resilience and cybersecurity, as evidenced in the introduction of HKMA's Cybersecurity Fortification Initiative 2.0 (effective from 1 January 2021), as well as additional guidance issued by the SFC in December 2020 on external electronic data storage (eg, cloud storage), a follow-up to its controversial October 2019 guidance setting out updated requirements for storing regulatory records in the cloud.

Another area of regulatory focus in 2020 was on climate risks and sustainability in the financial sector. This is evidenced by various initiatives introduced by the SFC, the HKMA and the Stock Exchange of Hong Kong (SEHK). For example, the SFC and the HKMA established the Green and Sustainable Finance Cross-Agency Steering Group, which aims to coordinate the management of climate and environmental risks to the financial sector. In December 2020, the Steering Group announced the launch of a strategic plan to bolster Hong Kong's position as a leading green and sustainable finance centre, including actions to strengthen climate-related financial risk management and promote the flow of climate-related information to facilitate risk management, capital allocation and investor protection. Also in June 2020, the HKEx announced its plans to launch the HKEx Sustainable and Green Exchange (STAGE), a comprehensive database of sustainable and green investment options that are available on Hong Kong's securities market, with a goal to promote the visibility, transparency and accessibility of sustainable and green finance across asset class and product type.

2020 saw a continued disciplinary focus by Hong Kong financial regulators on ensuring personal accountability of individuals working in the financial services industry. This was demonstrated by the SFC actions against individuals found to have been engaged in market misconduct, including actions to prohibit former responsible officers from re-entering the industry over IPO sponsor failures, theft and AML/CFT-related breaches. The HKMA also took action in this area, concluding a consultation in August 2020 on the implementation of a mandatory reference checking scheme under which recruiting banks would be required to obtain a reference from the prospective employees' current and former employers before a new employment relationship is established. This initiative aims to prevent individuals who were formerly engaged in misconduct (ie, the 'bad apples') from repeating their misconduct at a new financial services employer. Another example of this disciplinary focus is the SEHK's August 2020 announcement of its review of its existing disciplinary regime. The purpose of this proposed update (the first since 1993) is to ensure that there exists a spectrum of graduated sanctions in relation to breaches of the SEHK's Listing Rules. The proposals include introducing director unsuitability statements against individuals, as well as secondary liability for breaches of the Listing Rules in circumstances where the SEHK determines that the individual in question '... has caused by action or omission or knowingly participated in a contravention of the Listing Rules'.

The SFC also continued its recent focus on listed companies over the past year. The regulator reiterated its 'front-loaded' regulatory approach in tackling market and corporate conduct risk, with an emphasis on IPO sponsor work (especially in relation to the due diligence failures arising in the listing application context) and listed companies' transactions (including those conducted to transfer corporate control without disclosing the identities of the incoming controllers, as well as highly dilutive rights issues).

In February 2021, the SFC launched its long-awaited consultation on a proposed code of conduct on book-building and placing activities in equity capital market and debt capital market transactions. The proposed new code seeks to clarify the roles played by intermediaries in equity and debt capital raisings and set out the standards of conduct expected of them in book-building, pricing, allocation and placing activities. The SFC also hopes that its proposals will help tackle issues arising from competitive pressures in the book-building or placing context (eg, conflicts of interest) and align incentives with the responsibilities of intermediaries.

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24 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

The Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA) have both introduced measures aimed at alleviating the impact of the pandemic on regulated institutions, with a focus on ensuring that the financial markets continue to operate in an efficient and orderly manner, assuring investor protection, and preserving market integrity. While the regulatory expectation is that licensed corporations or individuals and other market participants should make all reasonable efforts to maintain 'business as usual' in relation to their regulatory obligations (including regulatory filing, reporting and other deadlines), there has inevitably been greater regulatory flexibility to enable financial institutions to continue to operate amidst the difficulties presented by the global pandemic. Regulated institutions are advised to continuously monitor the impact of the pandemic on its control and compliance risks and to contact the SFC and/or HKMA to the extent that they are facing particular difficulties in complying with the regulatory regime (eg, to check whether extensions and exemptions from strict compliance could be allowed).

The SFC and the HKMA have each published guidance on the various challenges and issues posed by 'the new normal', including working from home arrangements, staff working abroad due to quarantines or airport closures, restrictions on face-to-face interactions, and postal service suspension. Regulated institutions are advised to familiarise themselves with these coronavirus-related circulars and announcements, which can be located in the dedicated sections of the SFC and the HKMA websites.

The following are examples of pandemic-related guidance and measures introduced by the SFC over the course of 2020.

Investor protection

- In light of the impact of the pandemic on market volatility and liquidity, a Circular was issued to licensed and registered persons reminding them of their obligations under the SFC's Code of Conduct in relation to suitability in making a solicitation or recommendation and timely dissemination of information when distributing investment products to clients.
- Reminders to managers, trustees and custodians of SFC-authorised funds of their obligations to properly manage the liquidity of their funds and ensure fair treatment of investors amid the market volatility caused by the pandemic.

Regulatory compliance

- Increased flexibility to assist intermediaries and licensing applicants in fulfiling their obligations in licensing matters, including continuous professional training, notification to the SFC of certain covid-related staffing considerations, work abroad arrangements for staff due to travel restrictions, and overseas licence applications.
- Special guidance on the compliance with the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules in the context of suspension of Hong Kong and overseas postal services.
- Extended deadlines for intermediaries to implement recently announced SFC regulatory initiatives (eg, use of external electronic data storage; new measures to protect client assets; and data standards for order life cycles).
- Availability to certain groups of extensions to the deadlines applicable to submission of audited accounts and other required documents to the SFC.

Internal controls

- Guidance to licensed corporations concerning the monitoring and management of cybersecurity risks associated with remote office arrangements; and
- Reminders to intermediaries of the alternative order receiving and recording options to ensure compliance with order recording requirements as set out in the SFC's Code of Conduct.

Listed companies

- Special guidance jointly given by the SFC and the SEHK to listed companies concerning the timely issuance of financial results.

For its part, the HKMA announced the following selected relief measures and guidance in 2020:

- Guidance to authorised institutions encouraging the use of reliable remote/digital customer on-boarding initiatives, and supporting the use of simplified due diligence procedures (which generally require less face-to-face interaction) in cases where the AML/CFT risks are assessed to be low;
- Deferral of the timeline for implementation of Basel III reforms (e.g. revised frameworks on credit risk, operational risk, output floor and leverage ratio; revised market risk framework, and revised credit valuation adjustment framework;
- Lowering of the regulatory reserve requirement on locally incorporated authorised institutions by 50 per cent to provide authorised institutions with a greater lending headroom to support banking customers to cope with the pandemic; and
- Postponement of the 2020 Supervisor-Driven Stress Test to 2021.

In addition to the above-mentioned initiatives, the HKMA also introduced relief measures aimed at individuals and corporations, and encouraged authorised institutions' participation. These measures include (1) the introduction and extension of the Pre-approved Principal Payment Holiday Scheme for Corporate Customers to provide immediate relief to eligible small-to-mid-sized corporates facing financial issues in the wake of the pandemic outbreak, and (2) the launch of the Special 100% Loan Guarantee under the SME Financing Guarantee Scheme intended to ease the cash flow problems faced by enterprises adversely affected by covid-19.

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REGULATORY FRAMEWORK

Regulatory authorities

1 What national authorities regulate the provision of financial products and services?

The main piece of legislation specifying regulated financial services in the UK is the Financial Services and Markets Act 2000 (as amended) (FSMA) and its subordinate legislation. There is a tripartite system of regulators for financial services firms authorised under the FSMA; the Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA) and the Bank of England Financial Policy Committee (FPC). The scope of each regulator's authority is set out in the FSMA.

The FPC is the dedicated macro-prudential authority, and monitors the stability and resilience of the financial system as a whole, identifying and taking action to reduce systemic risk. The FPC can direct the FCA and the PRA to take certain action to combat systemic risk, but does not itself have direct regulatory responsibility for UK-authorised firms. The PRA is responsible for the authorisation and prudential regulation and supervision of firms that manage significant risk on their balance sheet (including banks, insurers and systemically important investment firms), while the FCA is responsible for the authorisation, prudential regulation and supervision of all other FSMA firms (including consumer credit firms and claims management companies), as well as the conduct of business of all firms.

The FCA is also responsible for the regulation of conduct in retail and wholesale financial markets, supervision of the trading infrastructure that supports those markets, and the authorisation and supervision of e-money issuers and payment services firms that fall outside the FSMA regulatory regime. The FCA also oversees the Payment Systems Regulator, which is an operationally independent subsidiary of the FCA that is the economic regulator for payment systems.

The PRA and FCA are obliged to ensure that their functions are exercised in a coordinated manner; for example, they must obtain advice or information from each other relating to the exercise of their functions under the FSMA on matters of common regulatory interest. A memorandum of understanding supports the relationship between the two regulators.

2 What activities does each national financial services authority regulate?

The FSMA provides that no person can perform a regulated activity without being authorised or exempt. A regulated activity is a specific activity that relates to a specified type of investment. The FSMA (Regulated Activities) Order 2001, a piece of subordinate legislation under the FSMA, specifies the following activities that, when performed in relation to specified products or investments, are regulated activities in the UK:

- deposit taking;
- issuing electronic money by credit institutions, credit unions and municipal banks;
- insurance-related activities (including effecting a contract of insurance and assisting in the administrator or performance of contracts of insurance);
- investment activities, including arranging deals in investments, advising on investments, dealing in investments, safeguarding and administering investments, managing investments, operating a trading facility and establishing or winding up a collective investment scheme;
- mortgage and home-finance-related activities, including mortgage lending and administration and entering into and administering home reversion and home purchase plans and sale and rent back agreements;
- consumer credit regulated activities;
- claims management activities; and
- other miscellaneous activities such as establishing a stakeholder pension scheme, specified financial benchmark administration activities, bidding in emissions auctions and certain activities in relation to the Lloyd's insurance market.

Agreeing to carry on a regulated activity is also generally a regulated activity.

The PRA is responsible for the authorisation of deposit takers, insurers, managing agents in the Lloyd's insurance market, the Lloyd's insurance market itself, and certain high-risk investment firms that have been designated by the PRA. Firms authorised by the PRA are subject to dual-regulation by the PRA and the FCA – the PRA is responsible for their authorisation, prudential regulation and supervision, while the FCA is responsible for regulating their conduct. All other FSMA firms are authorised, regulated and supervised by the FCA in respect of both prudential and conduct matters.

Separate regulatory regimes exist in the UK for the regulation of payment services and the issuance of electronic money by institutions other than credit institutions, credit unions and municipal banks (under the Payment Services Regulations 2017 (PSRs) and the E-Money Regulations 2011 (EMRs)). The FCA is responsible for the authorisation and supervision of e-money issuers and payment services firms.

3 What products does each national financial services authority regulate?

The following are specified products or investments for the purposes of the FSMA regime:

- deposits;
- e-money;
- contracts of insurance;
- shares;

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- instruments creating or acknowledging indebtedness;
- alternative finance investment bonds;
- government and public securities;
- instruments giving entitlements to investments;
- certificates representing certain securities;
- units in a collective investment scheme;
- rights under a pension scheme;
- options;
- futures;
- contracts for differences;
- Lloyd's investments;
- funeral plan contracts;
- regulated mortgage contracts;
- regulated home reversion plans;
- regulated home purchase plans;
- regulated sale and rent back agreements;
- rights to or interests in investments;
- greenhouse gas emissions allowances;
- rights under consumer credit and consumer hire agreements; and
- structured deposits.

Authorisation regime

4 | What is the registration or authorisation regime applicable to financial services firms and authorised individuals associated with those firms? When is registration or authorisation necessary, and how is it effected?

The PRA and the FCA have the power to authorise a firm to carry on regulated activities under the FSMA (only firms authorised or exempt under the FSMA may carry on FSMA-regulated activities in the UK).

A firm must apply to the PRA if its application includes certain PRA-regulated activities, such as deposit-taking or the writing of insurance contracts. These firms will have their application considered by both the FCA and the PRA. In any other case, the application will be made to the FCA only.

In the case of dual-regulated firms, the PRA leads the authorisation process. This includes pre-application meetings with the FCA and PRA; submission by the applicant of a detailed application pack including a core details form, a regulatory business plan, a controllers form, applications for certain key individuals (such as directors, senior managers and individuals responsible for compliance functions) to perform 'senior management functions' and an IT self-assessment questionnaire; and the payment of a fee ranging from £1,500 to £25,000 depending on the complexity of the application. The PRA and FCA must be satisfied that certain threshold conditions are met and that the firm will continue to meet certain minimum standards before granting any authorisation. The regulators must come to a decision within six months of the date it receives the completed application.

Applications to the FCA only follow a similar structure; however, the FCA has sole responsibility for the authorisation process.

Certain individuals performing key functions for authorised firms must also be pre-approved by the FCA or PRA (as appropriate). The senior managers regime applies to banks, building societies, credit unions, PRA-designated investment firms, insurers, and all other FSMA-authorised firms including benchmark administrators to whom it has applied since 7 December 2020. The senior managers regime extends to directors, partners, officers, senior managers and certain key employees (eg, the money laundering reporting officer and compliance officer). Applications for approval to perform 'senior management functions' must be made prior to the relevant individual's appointment, and the PRA and FCA have up to three months to determine an application.

A separate regime applies for payment services firms and e-money institutions. E-money or payment institution authorisation applications must be determined by the FCA within three months. In addition, firms that operate in lower risk environments, such as small e-money institutions and payments firms and consumer buy-to-let firms, may only need to be registered with the FCA.

Legislation

5 | What statute or other legal basis is the source of each regulatory authority's jurisdiction?

The FSMA is the basis of the FCA's and the PRA's jurisdictions in respect of FSMA-regulated activities and firms. The PSRs and the EMRs are the basis of the FCA's jurisdiction in relation to the payment services and e-money regimes. Following the withdrawal of the UK from the EU and the end of the implementation period on 31 December 2020, UK legislation that is derived from EU law (including FCA rules and secondary legislation that implements EU Directives) remains in force. Additionally, directly effective EU legislation that was in force and applicable as at 31 December 2020 was largely incorporated into UK law, or 'onshored', with effect from that date, subject to certain technical amendments to reflect that it only applies in the UK, including, for example, the transfer of functions from EU agencies to UK authorities.

6 | What principal laws and financial service authority rules apply to the activities of financial services firms and their associated persons?

The current regulatory framework in the UK derives largely from the FSMA and its secondary legislation. The main rules applicable to financial services firms are set out in a combination of retained EU law (such as the Capital Requirements Regulation, as it forms part of UK law) and the handbooks and rulebooks of the FCA and the PRA. The regulators also set out regulatory expectations in non-rule based materials such as policy statements, approach documents, thematic review reports and speeches.

Scope of regulation

7 | What are the main areas of regulation for each type of regulated financial services provider and product?

Firms performing regulated activities in the UK must generally be authorised by (or, for certain firms, registered with) one of the UK financial services regulators unless they benefit from an exemption or exclusion. Once authorised the requirements that apply vary depending on the types of regulated activities performed.

Most UK-authorised firms are subject to regulatory capital requirements, with banks, insurers and investment firms subject to the most stringent capital requirements.

Extensive regulatory rules and guidance also apply to regulated firms under the relevant UK legislation, including 'onshored' EU legislation, and the PRA and FCA rules and guidance.

The PRA and FCA rulebooks encompass both high-level standards for conduct, and systems and controls of regulated firms, as well as a number of requirements relating to a firm's day-to-day business, such as the management of client assets or the disclosures required to be made to clients and counterparties.

UK-regulated firms are under a general duty to inform the UK regulators of a material change in their business, management or of any significant regulatory rule breaches or complaints. In addition, firms are typically required to comply with periodic reporting obligations in respect of their ongoing operations.

Non-FSMA derived rules also apply to UK-regulated firms, such as the UK Money Laundering Regulations 2017 (MLRs). The FCA is responsible for supervising ongoing compliance with the MLRs and

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both prosecuting offences under that legislation and taking enforcement action for a lack of adequacy of systems of controls to prevent money laundering.

Additional requirements

8 What additional requirements apply to financial services firms and authorised persons, such as those imposed by self-regulatory bodies, designated professional bodies or other financial services organisations?

Financial services firms and senior managers may be subject to the rules and regulations of other professional or self-regulatory bodies. Whether firms are subject to any such rules or regulations, and the nature of those rules or regulations, will depend on the specific firms and bodies in question.

ENFORCEMENT

Investigatory powers

9 What powers do national financial services authorities have to examine and investigate compliance? What enforcement powers do they have for compliance breaches? How is compliance examined and enforced in practice?

Both the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) have a number of powers to investigate and take disciplinary action against firms and individuals who breach regulatory and some legal requirements.

The FCA has significant powers of investigation and information-gathering, which it can exercise against authorised firms. These powers are set out in the Financial Services and Markets Act (FSMA), and include powers to:

- require information and documents from authorised firms and connected persons;
- require a report on an authorised firm by a skilled person (and in some cases to appoint that person); and
- appoint both general and specific investigators.

The FCA has a number of disciplinary and enforcement powers, the most commonly used being the ability to issue public statements and censure, and to impose financial penalties. The FCA can also:

- vary or withdraw a firm's regulatory permissions, and impose restrictions or suspensions on a firm's ability to carry on regulated activities;
- withdraw or suspend an individual's approval, or restrict them in, or prohibit them from, performing certain functions;
- apply to court for injunctions in connection with certain matters; and
- prosecute certain criminal offences, including insider dealing and money laundering offences.

The FCA's overall approach to enforcement is a strategy of 'credible deterrence' (ie, to deter firms or individuals being disciplined from reoffending and to deter others from making similar mistakes). The FCA has published guidance on its policies and procedures and its approach to enforcement in its Decision Procedure and Penalties Manual and its Enforcement Guide. During 2018, the FCA consulted on its approach to enforcement and published a feedback statement that emphasised the FCA's mission of making its approach to enforcement more transparent.

The PRA has broadly the same information-gathering powers as the FCA against PRA-authorised firms and connected persons, and can also require the provision of skilled persons' reports (and to appoint skilled persons) and appoint investigators.

Like the FCA, the PRA has enforcement powers, although it is only able to impose penalties on PRA-authorised firms. The PRA has published statements of policy and procedures detailing how it will exercise its powers to impose financial penalties and suspensions, or impose restrictions on firms or senior managers.

Disciplinary powers

10 What are the powers of national financial services authorities to discipline or punish infractions? Which other bodies are responsible for criminal enforcement relating to compliance violations?

In addition to the powers and responsibilities of the FCA and PRA, various other bodies are also responsible for compliance enforcement in the UK, depending on the relevant legal or regulatory requirement. For example, the Information Commissioner's Office is the regulatory authority responsible for enforcement of breaches of UK data protection legislation, while the Office of Financial Sanctions Implementation (part of HM Treasury) enforces financial sanctions in the UK.

Tribunals

11 What tribunals adjudicate financial services criminal and civil infractions?

The FCA and PRA each have an internal decision-making process that applies in the context of enforcement action.

The FCA's Decision Procedure and Penalties Manual provides guidance on the nature and procedure of the FCA's Regulatory Decisions Committee, which is (in most cases) responsible for deciding whether to take enforcement action following an investigation. In August 2018, the Bank of England introduced an Enforcement Decision-Making Committee in respect of contested PRA enforcement actions.

Decisions taken by the FCA or PRA may be appealed by firms and individuals to the Tax and Chancery Chamber of the Upper Tribunal of the High Court.

A criminal prosecution brought by the FCA or PRA would be instituted in the criminal courts in England, Wales or Northern Ireland.

Penalties

12 What are typical sanctions imposed against firms and individuals for violations? Are settlements common?

Typically, fines are levied by the PRA and FCA against firms for violations. Discounts are ordinarily applied where firms cooperate with the regulators and for early settlement. In 2020, the FCA imposed fines of approximately £192.6 million, including a fine of £64 million levied against Lloyds Bank plc, Bank of Scotland plc and The Mortgage Business plc for failures in relation to their handling of mortgage customers in payment difficulties or arrears.

COMPLIANCE PROGRAMMES

Programme requirements

13 What requirements exist concerning the nature and content of compliance and supervisory programmes for each type of regulated entity?

Regulated firms are required to have in place systems and controls to ensure that they comply with applicable laws and regulatory requirements. The nature of these controls and compliance programmes varies depending on the size of the firm and the regulated activities performed. Compliance requirements are set out in a combination of UK legislation, and in Financial Conduct Authority (FCA) and Prudential Regulation

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Authority (PRA) rules and guidance. There are also a number of ways best practice may be conveyed to firms, including through ongoing supervision and as a result of thematic reviews undertaken by the FCA.

Gatekeepers

14 | How important are gatekeepers in the regulatory structure?

In recent years there has been a heightened focus on improving individual accountability for individuals working in financial services.

Senior individuals at FSMA firms performing certain key functions have to be pre-approved by the PRA and FCA pursuant to the senior managers regime. These functions broadly cover roles where individuals have managerial responsibility for a firm's affairs. Examples of individuals that need to be pre-approved include individuals performing executive director roles, the head of internal audit functions and compliance oversight. Financial institutions are expected to perform due diligence on prospective senior managers in advance of appointing these individuals. These approved individuals are subject to FCA or PRA conduct rules.

Directors' duties and liability

15 | What are the duties of directors and senior managers, and what standard of care applies to the boards of directors and senior managers of financial services firms?

In addition to the high-level requirements imposed on senior managers by the FCA or PRA, directors of financial institutions incorporated as companies in England are subject to high-level general and fiduciary duties set out in the Companies Act 2006 and common law. In particular, they are required to promote the success of the company, exercise independent judgement and exercise reasonable care, skill and diligence.

16 | When are directors and senior managers typically held individually accountable for the activities of financial services firms?

Senior managers have a duty of responsibility under the senior managers regime. The FCA and the PRA can take action against senior managers if:

- they are responsible for the management of any activities in their firm in relation to which their firm contravenes a relevant requirement; and
- they do not take the steps that a person in their position could reasonably be expected to take to avoid the contravention occurring (or continuing).

The burden of proof lies with the regulator to establish that a contravention has occurred and that the senior manager did not take the steps that an individual in his or her position could reasonably be expected to take to avoid the contravention occurring. The FCA and the PRA have produced separate but largely consistent guidance outlining how a senior manager should behave to comply with their duties of responsibility.

The duty of responsibility for senior managers is supported by conduct rules, which prescribe a base level of good conduct for staff. The FCA's conduct rules in respect of individuals at firms subject to the senior managers regime are set out in the Code of Conduct source-book, and the PRA's rules are set out in the Conduct Rules Part of the PRA Rulebook. The duty of responsibility applies to all senior managers at all authorised firms (other than benchmark administrators – to whom the senior managers regime will be extended later this year). The regulators can take disciplinary action against individuals for non-compliance with the conduct rules.

Private rights of action

17 | Do private rights of action apply to violations of national financial services authority rules and regulations?

Section 138D of the FSMA establishes a statutory right for certain private persons who suffer loss as a result of contravention by an authorised firm of an FCA or PRA rule to bring an action for damages, subject to the defences for breach of statutory duty (such as contributory negligence). There is a presumption that breach of an FCA rule is actionable unless the rule states to the contrary, whereas a PRA rule must expressly provide that it is actionable.

Customers may also be able to bring claims against investment firms in contract or tort where there has been a breach of a regulatory rule or requirement, and courts may look to the scope of regulatory rules to inform the scope of common law duties owed by investment firms to clients.

Standard of care for customers

18 | What is the standard of care that applies to each type of financial services firm and authorised person when dealing with retail customers?

Financial services firms are subject to high-level requirements to treat their customers fairly and to act in the best interests of clients, and a high standard of care applies to financial services firms when dealing with retail customers. Categorisation as a retail client offers the most protection to customers and imposes the most requirements on financial institutions dealing with such clients in terms of communication, disclosure and transparency.

Retail clients also benefit from the additional protections offered by the Financial Ombudsman Service, a UK ombudsman that considers and settles disputes between consumers and financial services businesses, and the Financial Services Compensation Scheme, a UK compensation scheme for customers of insolvent UK financial services firms.

In addition, since January 2019 the UK has introduced a ring-fencing regime around retail deposits held by UK financial institutions. The aim of this is to separate certain core banking services critical to individuals and small and medium-sized enterprises from wholesale and investment banking services, in order to insulate retail customers and smaller businesses from the possible failure of the investment banking entity.

19 | Does the standard of care differ based on the sophistication of the customer or counterparty?

Yes. Both UK MiFIR and various other UK regulatory regimes recognise that investors have different levels of knowledge, skill and expertise and that the regulatory requirements should reflect this.

For banks and investment firms, firms are required to categorise clients into retail clients, professional clients and eligible counterparties. Different regulatory protections apply for each of these categories, with those falling within the retail category – the less experienced, knowledgeable and sophisticated investors – afforded a higher level of protection than investors in the other categories.

In addition, the Payment Services Regulations allow payment institutions to disapply some of the conduct and information requirements set out in the regulations when dealing with certain corporate clients.

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Rule making

20 How are rules that affect the financial services industry adopted? Is there a consultation process?

At present, rules that affect the financial services industry in the UK encompass UK legislation (including retained EU law) and FCA and PRA rules and guidance. Formal guidance issued by certain EU bodies such as European Supervisory Authorities has not been incorporated into UK law but the FCA has expressed that it will continue to apply certain pre-Brexit guidance and recommendations as it relates to its functions and it expects market participants to make every to continue to comply with relevant guidance too.

The process for adopting rules and regulations, including whether a consultation is required and the manner of that consultation, depends on the nature of the rule being adopted. Generally, though, consultations are undertaken in respect of rules that will significantly affect the financial services industry.

CROSS-BORDER ISSUES

Cross-border regulation

21 How do national financial services authorities approach cross-border issues?

In December 2020, the UK and the EU agreed on a trade and cooperation agreement (the Trade and Cooperation Agreement) which covers the general objectives and framework of the relationship between the UK and the EU, including in relation to trade, transport, visas, judicial, law enforcement and security matters, and mechanisms for dispute resolution. Under the terms of the Trade and Cooperation Agreement, UK firms no longer benefit from automatic access to the EU single market and there is no longer the free movement of people between the UK and the EU.

Foreign financial institutions incorporated outside the UK are able to operate in the UK by establishing a UK-authorised branch or subsidiary, or alternatively may operate without a UK authorisation in reliance on certain overseas persons exemptions. The overseas persons exemptions allow overseas firms to provide certain financial services to UK customers on a cross-border basis, although the exemptions only apply to certain regulated activities (including dealing in investments, arranging transactions, advising on investments and certain mortgage related activities) and come with strict conditions preventing the overseas firm from having a physical presence in the UK.

International standards

22 What role does international standard setting play in the rules and standards implemented in your jurisdiction?

Generally, the UK seeks to implement international standards. EU and international regulatory policy and standards, and their implementation, supervision and enforcement in the UK, are integral to the remits of the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). The FCA also engages regularly with a wide range of European and international counterparts and stakeholders to enhance cooperation, share best practice and discuss issues of common interest.

UPDATE AND TRENDS

Key developments of the past year

23 Are there any other current developments or emerging trends that should be noted?

At the time of writing, the effect of the Trade and Cooperation Agreement on the UK economy and markets is unknown. It may be that in future UK firms will be able to provide certain types of services to professional clients and eligible counterparties in the European Economic Area on the basis of equivalence, however, any equivalence determination will be made at the EU's discretion. Market access on the basis of equivalence is much more limited compared to the access rights that existed pursuant to the EU passporting system for financial services firms.

24 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

In the wake of the coronavirus (covid-19) pandemic the Financial Conduct Authority (FCA) alongside HM Treasury and the Prudential Regulation Authority have made a series of interventions, while in parallel delaying other planned regulatory activities so that firms can focus on responding to coronavirus (covid-19). In particular, the FCA has emphasised the importance of business continuity arrangements and operational resilience for UK-authorised firms, which are expected to take all reasonable steps to continue meeting their regulatory obligations, manage their financial resilience and actively manage their liquidity while providing strong and transparent support and service to customers and small businesses.

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REGULATORY FRAMEWORK

Regulatory authorities

1 | What national authorities regulate the provision of financial products and services?

The structure of the regulatory regime for financial products and services in the United States is arguably the most complex of any jurisdiction, due to a variety of factors including historical precedent, the federalist nature of the US, and national politics. Recent changes since the financial crisis of 2008 were aimed at addressing regulatory gaps and systemic risk issues, although the financial regulatory structure has remained largely intact:

- Banking supervisors, market regulators and a consumer financial products agency have the authority to regulate the provision of financial products and services.
- Banks in the US may choose to be chartered at the state or federal level, and the applicable banking supervisor or supervisors depends on the charter type. The federal banking supervisors include the Board of Governors of the Federal Reserve System (the Federal Reserve), the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) (collectively, the Banking Regulators). The National Credit Union Association, which regulates credit unions, is outside the scope of this chapter.
- Financial products and services, financial markets and certain participants in those markets are regulated by the financial markets regulators. At the national level, these regulators include the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) (collectively, the Markets Regulators). In addition to these federal regulators, state authorities may also have jurisdiction to oversee certain products and services, although these supervisors are generally outside the scope of this chapter.
- The Consumer Financial Protection Bureau (CFPB) was formed in 2010 to focus on consumer protection with regard to financial products and services.

The complex array of supervisory agencies necessitates coordination between regulators.

2 | What activities does each national financial services authority regulate?

The Banking Regulators are tasked with monitoring the safety and soundness of depository institutions, and supervising all activities of depository institutions within their jurisdictions. The OCC regulates national banks and federal thrifts, and the Federal Reserve and FDIC serve as the primary federal regulator for state-chartered banks and thrifts – the former regulating state-chartered banks that choose to be Federal Reserve members, and the latter regulating non-member banks and state-chartered thrifts. The FDIC also has a role in regulating all federal and state banks and thrifts, as the insurer of their deposits. Finally, in its capacity as the consolidated supervisor of bank and thrift holding companies, the Federal Reserve oversees the activities of institutions that control or are affiliated with banks or thrifts.

The SEC regulates the offer and sale of securities (which include securities options and security-based swaps), US securities markets and certain market participants such as securities exchanges, clearing agencies, broker-dealers, investment advisers and investment funds. The CFTC regulates activities relating to most non-security derivatives – primarily futures, options on futures and swaps. Persons regulated by the CFTC include, among others, futures exchanges, derivatives clearing organisations, futures commission merchants (FCMs), swap dealers, commodity pool operators and 'commodity trading advisors'.

The CFPB regulates consumer financial products and services, which include among others, extensions of credit, certain real estate settlement services, cheque cashing and financial data processing.

Many financial institutions are subject to multiple regulators to the extent that they engage in multiple financial activities or are part of a diversified holding company structure.

3 | What products does each national financial services authority regulate?

The Banking Regulators exercise comprehensive supervisory oversight over the activities of depository institutions; however, certain Banking Regulators' rules apply specifically to certain types of products or activities (eg, consumer lending or fiduciary services).

The Markets Regulators regulate the offers and sales of financial products within their jurisdictions. The SEC regulates securities and does so primarily through a registration and disclosure regime and its anti-fraud authority. The SEC also focuses on investor protection and market integrity issues through rules that apply to intermediaries such as exchanges, broker-dealers and investment advisers. The CFTC regulates futures and swaps, among other derivative instruments. While most of the requirements relating to these instruments apply to registered entities, some apply more generally to users of these products (such as mandatory clearing for certain standardised swaps and, in some cases, swap trade reporting requirements).

The CFPB regulates consumer financial products and services, including deposit products, secured and unsecured loans, and prepaid cards.

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Authorisation regime

4 What is the registration or authorisation regime applicable to financial services firms and authorised individuals associated with those firms? When is registration or authorisation necessary, and how is it effected?

To accept deposits, an entity must be chartered as a depository institution by either a federal or state authority. The choice of charter determines both the legal framework that will apply and the regulator that will supervise the institution. In choosing the appropriate charter, an entity will likely consider most heavily the restrictions imposed, and the activities permitted by laws and regulations applicable to a depository institution (or its affiliates) based on the charter type.

To receive a charter, a proposed depository institution must apply to:

- the appropriate regulatory authority (ie, the OCC for national banks and federal thrifts);
- state regulators (for state banks and thrifts); and
- the FDIC in order to obtain deposit insurance.

In addition, if the proposed bank or thrift is under the control of a parent company, the parent company must apply to the Federal Reserve to become a bank or thrift holding company. The application process requires the submission of extensive materials, including detailed business plans, pro forma financial statements, and biographies and financial reports for proposed shareholders, directors and officers.

With regard to the Markets Regulators, the registration regime depends on the particular activity engaged in by a firm. For example, unless an exemption applies, a firm will have to register with:

- the SEC as an investment adviser if it is engaged in the business of providing investment advice to others for compensation;
- the SEC as a broker-dealer if it is engaged in the business of effecting transactions in securities for the account of others or buying and selling securities for its own account, other than in an ordinary trader capacity;
- the CFTC as a swap dealer if it is engaged in swap dealing activities above a de minimis threshold; and
- the CFTC as an FCM if it solicits or accepts orders to buy or sell futures or options on futures and accepts money or other assets from customers to support such orders.

Many firms regulated by a Markets Regulator must also become members of a self-regulatory organisation (SRO), which are subject to oversight by the relevant Markets Regulator. For example, broker-dealers must generally become members of the Financial Industry Regulatory Authority (FINRA) and swap dealers and FCMs must become members of the National Futures Association (NFA).

Registration for firms involves submitting an application to the relevant Markets Regulator or SRO. The application requirements vary but will generally request information regarding the ownership of the applicant, certain prior criminal, civil or regulatory history, evidence of financial and capital adequacy, information relating to its proposed operations and compliance capabilities, among others. Certain firm personnel are also subject to individual licensing and qualification requirements.

Legislation

5 What statute or other legal basis is the source of each regulatory authority's jurisdiction?

Each of the primary financial regulators in the US was created by statute to address a national crisis or market event:

- The OCC was created by the National Bank Act of 1864 as part of an effort to create the financial infrastructure necessary to finance the American Civil War.
- The Federal Reserve System was established under the Federal Reserve Act of 1913 in response to instability in the financial sector best represented by the Banking Panic of 1907, and the Federal Reserve has additional jurisdiction over depository institution holding companies and their non-depository institution subsidiaries under the Bank Holding Company Act of 1956 and the Home Owners' Loan Act.
- The FDIC and the system of federal deposit insurance were created during the Great Depression under the Banking Act of 1933 (which has since been replaced by the Federal Deposit Insurance Act of 1950) in response to the panic and bank runs that accompanied the economic downturn.
- The SEC was initially established pursuant to the Securities Exchange Act of 1934 (the Exchange Act), following the stock market crash of 1929, to oversee the US securities market and has additional jurisdiction relating to the offer and sale of securities under the Securities Act of 1933 (the Securities Act).
- The CFTC was created in 1974 pursuant to the Commodity Futures Trading Commission Act. At the time, the predecessor to the CFTC generally regulated only agricultural commodities. The CFTC, however, was granted the authority to regulate the growing trading in futures and options on non-agricultural commodities.
- The CFPB was established after the financial crisis of 2008 by the Consumer Financial Protection Act of 2010.

What principal laws and financial service authority rules apply to the activities of financial services firms and their associated persons?

The primary statute applying to national banks is the National Bank Act, which sets out the parameters for the activities in which national banks may engage. Bank holding companies and their non-bank subsidiaries are subject to activities limitations imposed by the Bank Holding Company Act of 1956. Federal thrifts and thrift holding companies are subject to the activities restrictions of the Home Owners' Loan Act. The activities of state banks and thrifts are primarily limited by state banking laws, but are also subject to federal limits set in the Federal Deposit Insurance Act. The Federal Reserve Act also imposes restrictions on the inter-affiliate activities of bank holding companies and thrift holding companies and their subsidiaries.

The primary statutes applying to financial services firms regulated by the SEC include:

- the Securities Act, which is generally designed to ensure that investors receive sufficient information regarding securities offered for public sale, and to prevent misrepresentations and other fraud in the sale of securities;
- the Exchange Act, which, among other things, authorises the SEC to regulate various securities market participants;
- the Investment Advisers Act of 1940 (the Advisers Act), which governs the regulation of investment advisers; and
- the Investment Company Act of 1940, which governs the regulation of investment companies, including mutual funds.

The primary statute applying to financial services firms regulated by the CFTC is the Commodity Exchange Act, which governs, among others, futures, options on futures and swaps, and certain persons that engage in activities with regard to those products.

The primary rules applying to financial services firms include the rules adopted to implement the foregoing statutes.

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The primary statutes applying to financial services firms regulated by the SEC include:

- the Securities Act, which is generally designed to ensure that investors receive sufficient information regarding securities offered for public sale, and to prevent misrepresentations and other fraud in the sale of securities;
- the Exchange Act, which, among other things, authorises the SEC to regulate various securities market participants;
- the Investment Advisers Act of 1940 (the Advisers Act), which governs the regulation of investment advisers; and
- the Investment Company Act of 1940, which governs the regulation of investment companies, including mutual funds.

The primary statute applying to financial services firms regulated by the CFTC is the Commodity Exchange Act, which governs, among others, futures, options on futures and swaps, and certain persons that engage in activities with regard to those products.

The primary rules applying to financial services firms include the rules adopted to implement the foregoing statutes.

Scope of regulation

7 | What are the main areas of regulation for each type of regulated financial services provider and product?

The principal areas of regulation for depository institutions and their holding companies include:

- activities restrictions;
- safety and soundness requirements;
- capital and liquidity requirements;
- lending restrictions;
- fiduciary regulations;
- consumer protection laws and regulations; and
- affiliate transaction restrictions.

For persons and entities regulated by the Markets Regulators, the principal areas of regulation include:

- registration requirements;
- capital and margin requirements;
- clearing requirements;
- business conduct standards;
- reporting requirements;
- requirements to adopt policies and procedures; and
- record-keeping obligations.

Additional requirements

8 | What additional requirements apply to financial services firms and authorised persons, such as those imposed by self-regulatory bodies, designated professional bodies or other financial services organisations?

Many firms regulated by a Markets Regulator must also become members of an SRO, such as FINRA or the NFA, and certain firm personnel must register with the same SRO and pass a qualification examination.

Securities and derivatives exchanges and clearing organisations are also SROs. As a result, market participants that have direct access to such exchanges or clearing organisations must become members of these institutions and comply with their rules.

Requirements imposed by SROs on their members vary depending on the type of regulated entity and the type of SRO. In some instances, SRO rules implement existing federal statutory or regulatory requirements. In other cases, SROs are provided with discretion to adopt additional or more detailed requirements. FINRA, for example, in addition to enforcing the Exchange Act and SEC rules, imposes extensive obligations on all aspects of a broker-dealer's activities and requires its member broker-dealers to comply with 'just and equitable principles of trade', which is a higher conduct standard than the anti-fraud standard that the SEC can impose under the Exchange Act.

ENFORCEMENT

Investigatory powers

9 | What powers do national financial services authorities have to examine and investigate compliance? What enforcement powers do they have for compliance breaches? How is compliance examined and enforced in practice?

The Banking Regulators, the Consumer Financial Protection Bureau (CFPB), the Markets Regulators and self-regulatory organisations (SROs) have broad authority to examine the entities they supervise (and, in some cases, their affiliates) for compliance with applicable laws, rules and regulations. They also have enforcement powers to address legal and regulatory violations. How these authorities are exercised in practice varies by regulator.

The Banking Regulators are prudential regulators, supervising institutions within their jurisdiction to monitor their safety and soundness, as well as their compliance with federal banking laws and regulations. Each of the Banking Regulators regularly conducts on-site safety and soundness examinations to assess the financial and managerial soundness of the regulated institution. In addition, the Banking Regulators conduct examinations that focus on compliance with particular legal and regulatory requirements, such as anti-money laundering laws or community investment and lending requirements. To address violations of laws or regulations or the finding of unsafe or unsound practices, the Banking Regulators may informally require regulated institutions to remediate or may bring formal enforcement actions.

The CFPB is a new federal agency formed in 2010, which has the authority to supervise and examine banking institutions with more than US$10 billion in assets, as well as their affiliates (unless excepted), for compliance with federal consumer financial protection laws. The CFPB has the authority to bring enforcement actions not only against institutions it supervises, but against any institution that engages in financial transactions with consumers, for violations of applicable federal consumer financial laws or for engaging in acts or practices that are deemed unfair, deceptive or abusive.

The Markets Regulators examine regulated institutions for compliance with applicable laws and regulations both directly and indirectly through examinations by the SROs – which conduct their own examination

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and enforcement activities. In addition, the Markets Regulators have the authority to conduct informal or formal investigations of potential misconduct and to bring enforcement actions. Such potential misconduct may come to the attention of the Markets Regulators through a variety of channels, including through examinations, complaints from the public or referrals from other government agencies. Markets Regulators and their related SROs are generally viewed as having more of an enforcement focus than the Banking Regulators.

Disciplinary powers

10 What are the powers of national financial services authorities to discipline or punish infractions? Which other bodies are responsible for criminal enforcement relating to compliance violations?

The Banking and Markets Regulators and the CFPB have civil enforcement powers and can pursue a variety of civil remedies.

The Banking Regulators have the power to pursue a variety of civil remedies, both informal and formal, against depository institutions and their affiliates, as well as associated individuals, for unsafe and unsound practices or compliance violations. Informal remedies include commitment letters, memoranda of understanding or the issuance of findings entitled 'matters requiring attention'. Formal remedies against firms may include cease-and-desist orders, formal written or supervisory agreements, prompt corrective action directives and civil money penalties. Formal remedies against individuals associated with depository institutions include removal and prohibition orders, cease-and-desist orders, restitution orders and civil money penalties.

The Markets Regulators have the power to seek a variety of civil remedies against both firms and individuals. Sanctions include injunctions or cease-and-desist orders, revocation or suspension of an individual's or entity's registration and exchange trading privileges, restitution orders, disgorgement of ill-gotten profits and civil money penalties. Certain industry and conduct-related bars may also be available.

SROs, such as FINRA and the National Futures Association (NFA), also have authority to discipline infractions committed by their members in violation of the application statutes, or the rules of the Securities and Exchange Commission (SEC) (in the case of FINRA) or Commodity Futures Trading Commission (in the case of the NFA) and their own rules. SROs generally have the authority to fine, suspend or bar individuals and firms from the industry, among others.

To the extent that regulated entities' or individuals' compliance failures constitute violations of criminal law, the Department of Justice, a US attorney's office or local law enforcement agencies may institute a criminal proceeding, either on their own initiative or upon a referral from the applicable Banking or Markets Regulator.

Tribunals

11 What tribunals adjudicate financial services criminal and civil infractions?

Federal district courts in the US adjudicate violations of both civil and criminal federal law. The Banking Regulators, the CFPB and the Markets Regulators may pursue civil violations of federal financial laws and regulations in the federal district courts, although the Banking Regulators generally elect to use administrative proceedings rather than court proceedings. Criminal financial services violations are also adjudicated in the federal district courts. To the extent that compliance failures constitute violations of state law, whether civil or criminal, such infractions would generally be tried in a state civil or criminal court, although federal courts may hear certain civil claims involving parties from different states.

The Banking Regulators, Markets Regulators and CFPB may also seek civil penalties and other remedies in administrative proceedings. Administrative proceedings are presented before administrative law judges, who may be employees of the particular financial services authority. These proceedings may result in non-judicial findings of fault or wrongdoing. Certain financial services authorities, such as the SEC, rely heavily on administrative proceedings, while others, like the Federal Reserve, use administrative proceedings less frequently.

Finally, SROs may institute disciplinary proceedings against members that are heard before their own internal bodies, although these may ultimately be appealable to the Markets Regulator itself.

Penalties

12 What are typical sanctions imposed against firms and individuals for violations? Are settlements common?

The majority of enforcement actions pursued by the Banking and Markets Regulators are resolved via settlement, including through cease-and-desist orders, removal and prohibition orders, civil money penalties, and disgorgement orders. The size of monetary sanctions imposed in a given case ranges significantly depending on the nature of the case. The largest penalties tend to be imposed in settlements in which the respondent knowingly violated the law and caused a pecuniary loss as a result.

In addition to imposing penalties, the Banking and Markets Regulators often require settling institutions to undertake substantial remediation efforts to improve policies, procedures, controls and governance, among other things, to mitigate the risk that the activity giving rise to the settlement will reoccur.

A unique and often-criticised aspect of the US financial regulators' settlement practices is the ability of respondents to settle with the regulators without admitting wrongdoing. Commonly referred to as 'neither-admit-nor-deny' settlements, the Banking and Markets Regulators justify this practice by asserting that it allows them to impose consequences on respondents quickly and obtain necessary relief for victims, while also avoiding burdensome litigation costs.

COMPLIANCE PROGRAMMES

Programme requirements

13 What requirements exist concerning the nature and content of compliance and supervisory programmes for each type of regulated entity?

The Banking Regulators, who act as prudential supervisors, are focused on monitoring the safety and soundness of depository institutions and their holding company system in a comprehensive manner. Thus, the Banking Regulators expect supervised institutions to adopt an effective risk-management programme that manages compliance risk alongside the other risks present in an institution's business. As a general matter, the Banking Regulators expect that a regulated institution's risk-management programme will reflect its size, resources and complexity, and will be proportionate to the risks present in its business.

No matter the size of the entity, an effective compliance programme for entities subject to the Banking Regulators' supervision will include among other features:

- adequate policies and procedures to safeguard and manage assets;
- a clear organisational structure that establishes responsibility for monitoring adherence to established policies;
- controls that facilitate effective assessment of risks; and
- an internal audit system.

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The Markets Regulators have similar requirements for the content of their regulated entities' compliance programmes, although the precise expectations may depend on the type of regulated entity. In general, the Markets Regulators, either directly or through self-regulatory organisation (SRO) rules, require their regulated institutions to:

- adopt and implement written policies and procedures reasonably designed to prevent violations of applicable law;
- periodically review the adequacy and effectiveness of such policies and procedures; and
- designate a chief compliance officer to administer such policies and procedures and regularly evaluate their effectiveness.

Gatekeepers

14 | How important are gatekeepers in the regulatory structure?

The national financial services authorities place great emphasis on internal gatekeepers, such as chief compliance officers (CCOs), internal auditors, risk-management personnel and others who have a general obligation to identify and prevent potential misconduct.

As discussed above, regulatory expectations for risk management in depository institutions vary depending on a regulated institution's size, resources and complexity. Currently, national banks and federal thrifts with more than US$50 billion in consolidated assets are expected to implement a 'three lines of defence' risk-management programme, which requires the business line to assume first-line responsibility for compliance, an independent risk-management function headed by a chief risk executive (second line), and an independent audit function headed by a chief audit executive (third line). In this structure, the chief risk executive and chief audit executive have unrestricted access to the institution's board of directors. In large institutions, the second and third lines of defence are crucial for monitoring and assessing the institution's activities, as well as recommending areas for improvement. The Banking Regulators often look to second- and third-line reports as part of their own examination processes.

The Markets Regulators similarly place great emphasis on internal gatekeepers. Since the financial crisis, regulations have assigned additional responsibilities and increasing accountability to such personnel through periodic certifications. For example, the Commodity Futures Trading Commission (CFTC) adopted a rule requiring CCOs of futures commission merchants and swap dealers to take reasonable steps to ensure compliance with applicable rules, and prepare and sign an annual report that provides an assessment of the effectiveness of the firm's policies and procedures, and describes any material non-compliance issues identified and the corresponding action taken. This report must also include a certification by the CCO or chief executive that the information contained in the annual report is accurate and complete in all material aspects. Markets Regulators also view their regulated institutions as themselves acting as gatekeepers to the industry, and in some cases expect them to surveil for and prevent misconduct by third parties using their services.

Directors' duties and liability

15 | What are the duties of directors and senior managers, and what standard of care applies to the boards of directors and senior managers of financial services firms?

State corporate laws and common law generally govern the duties of the directors of US corporations, including financial services firms. Directors are ultimately responsible for the overall direction and strategy of the firm. A board carries out this responsibility primarily by setting the 'tone at the top' and selecting, retaining and overseeing the firm's managers, who direct daily operations. The board retains, however, the responsibility to evaluate and approve major decisions in the life of the firm.

When carrying out their responsibilities, directors of a US corporation owe the firm and its stockholders certain fiduciary duties, namely, the duties of care and loyalty. The duty of care generally requires directors to act with the care that a reasonably prudent person in a like position would use under similar circumstances. The duty of loyalty generally requires directors to act in good faith and in the best interests of the firm and its stockholders (and not for their own interests). In general, the business judgment rule applies to protect directors from judicial second-guessing when they have acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company.

Bank directors may be held to a heightened standard with regard to these fiduciary duties, as courts have found that they must be concerned with the welfare of depositors as well as stockholders.

In addition to these general corporate responsibilities, the Banking and Markets Regulators have issued rules and guidance outlining specific responsibilities of boards of directors of financial institutions, which can be extensive.

16 | When are directors and senior managers typically held individually accountable for the activities of financial services firms?

Directors of financial services firms may be held individually liable (to shareholders or the applicable regulator) if they breach their fiduciary duties; however, as described above, the business judgment rule applies to protect directors from judicial second-guessing when they have acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company.

In addition to being held accountable for breaches of fiduciary duties, directors of depository institutions could be subject to enforcement actions brought by the Banking Regulators for violating federal banking laws or engaging in unsafe or unsound practices, with the degree of the penalty – and the likelihood of an enforcement action – heightened depending on the director's mens rea and the extent of the consequential loss to the bank or pecuniary gain or benefit to the director. In addition, if a director of a national bank knowingly violates, or knowingly permits officers or agents of a bank to violate, federal banking laws, the bank could be dissolved and the director could be held liable in a personal and individual capacity for all damages that the bank, its shareholders or others may have sustained as a consequence of the violation.

Directors of financial services firms that are regulated by the Markets Regulators are considered to be 'control persons' and, as a result, may be held personally liable for the acts of the controlled entity if he or she failed to act in good faith or otherwise knowingly induced or engaged in the acts constituting the violation.

Private rights of action

17 | Do private rights of action apply to violations of national financial services authority rules and regulations?

Whether a private right of action would or likely could exist for a violation of a national financial services authority statute or rule depends on the particular statute or rule at issue and how courts have interpreted them. Generally, a private right of action is available only where such a right is provided for in the statute or rule that is alleged to have been violated. Even where a private right of action is not specifically enumerated in a statute or rule, courts have occasionally found private rights of action to be implied based on legislative intent and other factors. Most financial services authority rules and regulations, however, have not been found to carry private rights of action.

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Standard of care for customers

18 What is the standard of care that applies to each type of financial services firm and authorised person when dealing with retail customers?

The standard of care that applies when dealing with retail customers varies by the type of financial services firm and, in some cases, the particular capacity in which the financial services firm is servicing the customer.

Depository institutions must take care not to engage in unfair, deceptive or abusive acts or practices (UDAAPs) in any interaction with retail customers. These terms have been interpreted by the Banking Regulators, the Consumer Financial Protection Bureau (CFPB) and courts, which have developed tests for determining if an activity rises to the level of a UDAAP. The Banking Regulators only have the power to take action against depository institutions that conduct unfair or deceptive acts or practices. The CFPB has the full complement of powers and can take action against UDAAPs. There are also a multitude of laws and regulations that relate to the delivery of specific products and services by depository institutions, many of which are designed to protect the consumer.

Generally, depository institutions are not subject to fiduciary duties with regard to retail customers, unless they are acting in a fiduciary capacity (eg, a trustee or executor), in which case, state law governing duties owed by a fiduciary or, in some cases, federal law, may apply.

SEC-registered investment advisers are deemed fiduciaries under the Advisers Act and must accordingly comply with the duties of loyalty and care when interacting with all of their customers, including retail customers. The SEC and courts have interpreted these fiduciary duties as requiring investment advisers to act with utmost good faith in the best interests of their clients, make full and fair disclosure of all material facts, and employ all reasonable care to avoid misleading clients. The Advisers Act imposes further limitations on an investment adviser's dealings with customers.

Broker-dealers are generally not considered fiduciaries, although they nevertheless are subject to, at least, a duty of fair dealing. This duty is derived from common law agency principles and the anti-fraud provisions of the federal securities laws, and is also reflected in SRO rules. For example, FINRA requires its member broker-dealers to observe high standards of commercial honour and just and equitable principles of trade. In addition, broker-dealers must comply with other requirements that affect how they interact with customers, including:

- suitability and 'best interest' requirements, which generally require broker-dealers to recommend only those specific securities or overall investment strategies that are suitable for their customers or (effective June 2020) in the case of retail investors, securities or investment strategies that are in the 'best interest' of the retail investor, without putting the interests of the broker-dealer ahead of the customer; and
- the duty of best execution, which generally requires broker-dealers to seek to obtain the most favourable terms available under the circumstances for their customer orders.

19 Does the standard of care differ based on the sophistication of the customer or counterparty?

Banks acting as fiduciaries and SEC-registered investment advisers must exercise their fiduciary duties, including the duties of loyalty and care, no matter the sophistication of the customer or client. The standards for satisfying their fiduciary duties, however, may become more stringent as the sophistication decreases, as care that is reasonable when dealing with an institutional investor may not be reasonable when dealing with a retail customer.

Other aspects of US financial services rules and regulations may apply differently depending on the characteristics of a customer that serve as a proxy for sophistication. For example, a broker-dealer recommending a security to an 'institutional account' may qualify for an exemption from its obligation to conduct a customer-specific suitability analysis provided specified conditions are met. Similarly, effective June 2020, recommendations to retail investors are subject to the heightened 'best interest' standard.

Rule making

20 How are rules that affect the financial services industry adopted? Is there a consultation process?

The Banking and Markets Regulators are federal agencies and, thus, are subject to the US Administrative Procedure Act (APA), which sets out the process by which agencies may promulgate rules. These agencies generally use the APA's notice-and-comment process to promulgate rules pursuant to either their general statutory rulemaking power or an express statutory directive.

To initiate the notice-and-comment process, the agencies issue a notice providing the public a draft of a proposed rule and explaining the statutory authority and purposes for that rule. The public is given a period of time – typically 60 to 90 days – to review and comment on the proposed rule. Agencies may also meet with financial institutions or trade associations to discuss the proposed rule and comment letters.

After considering the comments submitted, the regulators may issue final rules, which typically become effective 60 days to one year after the final rule is issued. Any person with standing to challenge the rule in court may do so on certain stipulated grounds, including by bringing a claim that the agency acted in an arbitrary and capricious manner. SRO rulemaking is also indirectly subject to the APA. For example, FINRA rules must be approved by the Securities and Exchange Commission (SEC), and therefore the SEC promulgates these proposed SRO rules for notice and comment before they may take effect.

CROSS-BORDER ISSUES

Cross-border regulation

21 How do national financial services authorities approach cross-border issues?

The way in which the Banking and Markets Regulators approach cross-border issues varies by type of financial services firm and, in some cases, the type of activity. In many cases, the applicable statute takes a territorial view when drawing the perimeter of US regulatory jurisdiction. For example, unless an exemption applies, a non-US entity will generally need to obtain a bank charter, establish a bank branch, agency or representative office, or register as a broker-dealer if it solicits banking or broker-dealer services to persons located in the US or engages in such activities within the United States. A non-US entity could, however, provide banking or broker-dealer services to persons located outside the US without triggering the application of US banking and broker-dealer laws, respectively, so long as the interactions with the customer occur outside the US. Other categories of registrants, however, such as investment advisers and swap dealers may be required to register with the Securities and Exchange Commission (SEC) or Commodity Futures Trading Commission (CFTC), respectively, if they provide services to US persons, regardless of their location.

With regard to certain cross-border transactions, the Banking and Markets Regulators have adopted exemptions and mutual recognition frameworks. For example, the Bank Holding Company Act of 1956 broadly exempts non-US activities of non-US banks, and under the uncleared swap margin rules adopted by the Banking Regulators and

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the CFTC, certain non-US swap dealers with regard to some swap transactions are permitted to comply with such rules by complying with the margin rules of another jurisdiction, if the applicable US regulator issues a determination that such other jurisdiction's rules are comparable to the US requirements. With regard to broker-dealer registration, non-US firms may be permitted to engage in limited activity in the United States without US registration pursuant to exemptions, including in some cases where the non-US firm is 'chaperoned' by a US-registered broker-dealer.

International standards

22 What role does international standard setting play in the rules and standards implemented in your jurisdiction?

The Banking and Markets Regulators actively participate in international standard-setting organisations. For example, the Banking Regulators are members of the Basel Committee on Banking and Supervision, an international forum focusing on banking supervisory matters; the Federal Reserve and the SEC are members of the Financial Stability Board, an international body that promotes international financial stability; and the SEC and CFTC are members of the International Organization of Securities Commissions (IOSCO), a multilateral organisation that develops and promotes adherence to internationally recognised standards for securities regulation.

While the agreements reached by these international organisations are not self-executing, the Banking and Markets Regulators may implement the agreed-upon standards by promulgating rules pursuant to their general statutory grants of authority.

UPDATE AND TRENDS

Key developments of the past year

23 Are there any other current developments or emerging trends that should be noted?

Effective from 30 June 2020, the Securities and Exchange Commission (SEC) adopted Regulation Best Interest, which heightens the standards that broker-dealers must maintain towards retail investors when making recommendations about securities or investment strategies.

While no implementing regulations have been issued, the US Congress passed the Anti-Money Laundering Act of 2020 (AML Act of 2020), one of the most significant US anti-money laundering laws in decades. Among other things, the AML Act of 2020 would: (1) establish a beneficial ownership database designed to address 'shell companies' and administered by the Financial Crimes Enforcement Network ; (2) provide for new violations of the Bank Secrecy Act, as well as increased penalties for repeat and egregious violators; (3) grant expanded authority for the US government to issue subpoenas regarding non-US bank accounts; and (4) provide increased protections, and rewards, for whistle-blowers.

Effective 30 September 2020, the Federal Reserve finalised a rule intended to simplify and provide increased transparency into the circumstances where one company would be viewed as having a 'controlling influence', and thus 'control', over another company for purposes of the Bank Holding Company Act of 1956. This rule revises and codifies the meaning of ' controlling influence' by providing a series of tiered presumptions, based mainly on the level of voting shares held by an investor and also considering total equity, director representation, business relationships, contractual rights and other factors. The presumptions in many ways represent a liberalisation of Federal Reserve precedent, although the final rule is generally consistent with Federal Reserve precedent where the lower the level of voting equity held by an investor, the less restrictive the presumptions of control (and vice versa).

Effective 1 April 2021, the Federal Deposit Insurance Corporation (FDIC) adopted a final rule that clarified expectations related to commercial parent companies of industrial loan companies (ILCs). This final rule, which formalised long-standing supervisory expectations, requires a new ILC to enter into a written agreement with the ILC parent and the FDIC containing at least eight specific commitments, including commitments related to maintaining the ILCs capital and liquidity. The final rule requires prior FDIC approval for certain changes at the ILC level, such as material changes to its business plan, adding or replacing directors or senior executive officers during the initial three-year period of the ILCs existence, and entering into services agreements with the ILC's parent or affiliates. It also imposes certain corporate governance standards such as a requirement that an ILC parent limit its representation on the board of a subsidiary ILC to less than 50 per cent.

Effective 1 October 2020, the Banking Regulators and Markets Regulators implemented changes to the covered funds provisions of final regulations implementing section 13 of the Bank Holding Company Act of 1956, commonly referred to as the Volcker Rule. These changes provided several new exclusions from the definition of covered fund, codified certain existing guidance and regulatory statements, provided new exemptions for 'qualifying foreign excluded funds' and from the 'Super 23A' restrictions regarding transactions between a banking entity and a related covered fund, and clarified the manner in which a banking entity must calculate its ownership interests in a covered fund.

24 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

Effective from 27 March 2020, the US Congress enacted an economic relief package, known as the CARES Act, to provide over US$2 trillion in support to households and businesses. Key provisions of the CARES Act included financial support for Federal Reserve emergency lending programmes, aid for airlines and national security-critical businesses, expanded unemployment benefits and direct payments to individuals, temporary mortgage foreclosure relief, and authorisation for numerous actions to be taken by the Banking Regulators. In addition, the CARES Act authorised the Paycheck Protection Program (PPP), through which small businesses could receive forgivable loans for payroll and related expenses. Effective from 27 December 2020, a supplemental economic relief package, known as CARES 2.0, extended certain aspects of the CARES Act, including the PPP.

Beginning in March 2020, the Federal Reserve took extensive monetary policy and regulatory actions to support the financial system and broader economy. The Federal Reserve's monetary policy actions included cutting the federal funds interest rate to zero to .25 per cent, encouraging discount window borrowing, engaging in quantitative easing, and announcing currency swap lines with foreign central banks, effective 15 March 2020. In addition, following a similar approach to that taken during the financial crisis of 2008, the Federal Reserve also established numerous emergency lending facilities under the emergency authority of section 13(3) of the Federal Reserve Act. These included programmes, some of which received funding under the CARES Act, supporting the markets for commercial paper, money market mutual funds, asset-backed securities, corporate debt, and municipal debt, as well as a Main Street programme intended to support lending to small and mid-sized businesses and nonprofits.

In part in support of banks' participation in the Federal Reserve's emergency lending facilities, the Banking Regulators enacted numerous regulatory and supervisory measures with respect to bank capital and

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liquidity requirements. For example, the Banking Regulators encouraged banks to draw down their capital and liquidity buffers to support lending activity to households and businesses. The Banking Regulators also promulgated several rules with technical modifications to capital and liquidity requirements to neutralise the impact of increased lending activity, including in support of particular Federal Reserve emergency lending facilities. In addition, to examine the impact of covid-19 on bank capital on a forward-looking basis, the Federal Reserve included in its annual capital stress test a covid-19 sensitivity analysis. Based on those results, the Federal Reserve suspended banks' share repurchases, capped dividends and required capital plan resubmissions.

Beyond capital and liquidity regulation, the Banking Regulators, Market Regulators, and other regulators undertook numerous other extraordinary actions to support the financial system and economy in light of the covid-19 pandemic. These measures covered a wide range of topics, from actions related to mortgage forbearance, eviction moratoria and loan modifications to extensions of reporting and public comment deadlines to rule changes and guidance to accommodate the transition away from in-person and physical activities to a remote working environment. The regulators also issued a plethora of guidance advising businesses and consumers of modifications to their approaches to supervision, disclosure, reporting and data collection in response to the unique challenges posed by the pandemic. Additional changes occurred at the state and local level. Some of these measures were extended – in some cases, multiple times – as the pandemic continued, and, as of the date of this publication, it remained to be seen how long many of these changes would last.

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