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Financial Services Compliance 2021

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Lexology Getting The Deal Through is delighted to publish the fourth edition of *Financial Services Compliance*, which is available in print and online at www.lexology.com/gtdt.

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.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

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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Introduction

Zachary J Zweihorn

Davis Polk & Wardwell LLP

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.

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 multi-lateral 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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We deliver leading-edge thought leadership on financial services regulation on our FinReg blog (finregreform.com), covering topics including fintech and regulatory reform.

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