EVIA European Venues & Intermediaries Association

LEBA London Energy Brokers' Association

EVIA & LEBA Compliance Advisory; Regulatory Activities & Initiatives Grid;

Wednesday 01st March 2023

Full Grid and Outlook Below

1. Regulatory Barometer - Operational Resilience
2. UK Regulatory Plans: 2023
3. EU Regulatory Plans: 2023
4. Rulemaking Forward Planning Diary
5. Highlights from the Regulatory Environment in February
    - a BMR & LiBOR Transition Update
    - b MAR News
    - c Fintech, SupTech & Reg Tech Developments
    - d Sanctions Requirements
    - e Conduct, Fines & Enforcements
    - f Prudential Notes
    - g ESG,

Regulatory Outlook and Diary

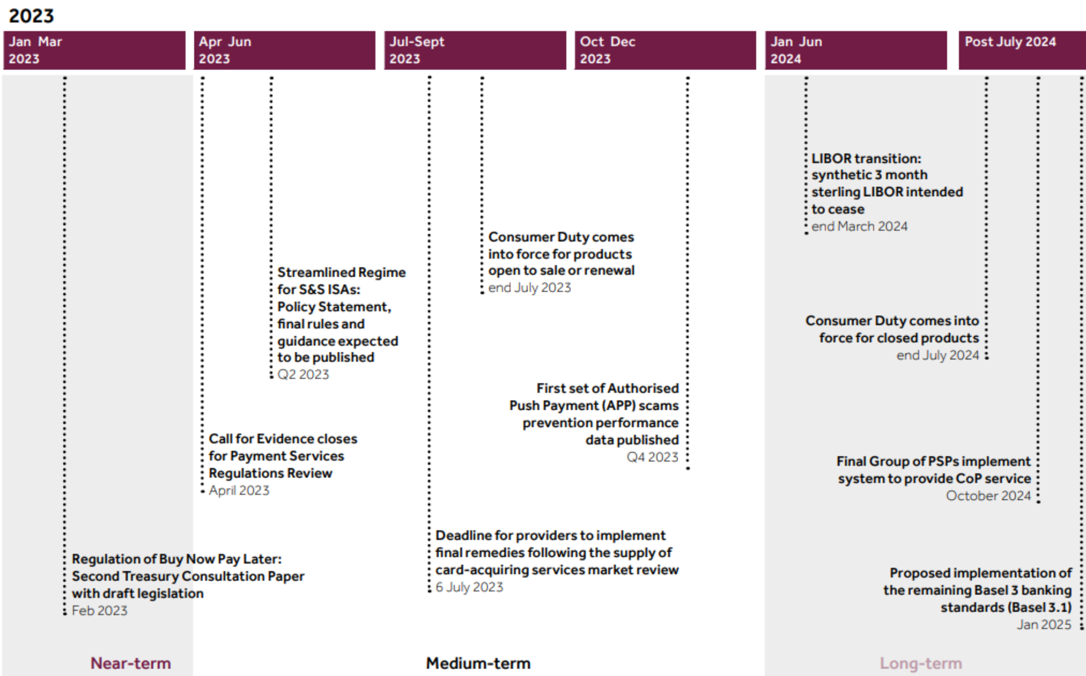
FCA 5 month delayed update to the UK Regulatory Initiatives Grid; FCA et al* are setting out the planned regulatory initiatives for the next 24 months.

- View the latest Regulatory Initiatives Grid – February 2023 (PDF)
- View the interactive dashboard

This Grid from the ***Financial Services Regulatory Initiatives Forum*** [1] sets out the regulatory pipeline. This is so the financial services industry and other stakeholders can understand – and plan for – the timing of the initiatives that may have a significant operational impact on them. We have also published the Grid in the form of an interactive dashboard and an Excel spreadsheet to help users interact with the underlying data. <- *this is quite cleverly done!*

The key initiatives in the regulatory landscape

[1] *This Forum was launched to strengthen coordination between members. It is made up of representatives of the Bank of England, Financial Conduct Authority, Prudential Regulation Authority, Payment Systems Regulator, the Competition and Markets Authority, the Information Commissioner's Office, The Pensions Regulator and the Financial Reporting Council. HM Treasury is an observer member.*



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Updating the Grid; *FCA/ BOE/ PRA/ HMT/ ICO/ CMA/ PSR/ TPR* collectively publish the Grid twice a year to help manage the operational impact on firms of implementing initiatives from the Forum members. It also helps firms and other stakeholders plan for forthcoming initiatives. The Grid provides detail on the timing of initiatives over a 24-month horizon and

highlights key examples of closely interconnected initiatives to help stakeholders easily identify these.

- We have now published the latest version of the Grid (February 2023). This was delayed from November 2022 to allow Forum members the opportunity to consider the potential implications on the regulatory pipeline and initiatives in the upcoming Grid of the Government's Edinburgh Reforms, which were announced in December 2022. These initiatives are reflected, where appropriate, in the latest Grid.
- This will be the first Grid of 2023 and the next will be published towards the end of the year. However, in recognition of the length of time between those publications, and in recognition of the impact of the Financial Services and Markets Bill, we aim to provide a short update after Royal Assent, which is subject to Parliamentary timing, informing the sector on any important and imminent changes.

Regulatory Calendar in Respect of Wholesale financial markets

Lead	Initiative	Expected key milestones	Indicative impact on firms	Dates
FCA	Accessing and using wholesale data; Market study assessing potential competition issues about benchmarks, credit rating data and market data vendors.	Launch of market study now planned for later in Q1 2023 to align with findings of trade data review. FCA published this update on timing on our external webpage.	H	Timing Updated Jan/Mar 2023 April / June 2023
FCA	Accessing and using wholesale data Trade data review; Assessment of potential competition issues and concerns about effectiveness of regulatory provisions in relation to trade data.	Feedback Statement published 11 January 2022 Trade data review launched June 2022 Publication of findings and next steps - planned for later in Q1 2023.	L	Timing Updated Jan/Mar 2023
BoE/ FCA/ HMT/ PRA	LIBOR Transition; Secure a fair, clear and orderly transition from LIBOR to robust, reliable and clean alternative risk-free rates	The FCA has compelled production of synthetic LIBOR for a limited number of settings and has been clear that these synthetic settings are only a temporary measure. Following FCA announcements in November 2022, end dates have now been announced or proposed for all LIBOR settings. End-March 2023: Synthetic 1-month and 6-month sterling LIBOR will cease.	H	Jan/Mar 2023 April / June 2023

		End June 2023: Overnight and 12-month US dollar LIBOR will cease. UK authorities are and will continue to work closely with international counterparts to monitor any new use of US dollar LIBOR and remove dependency on it in legacy contracts. End-March 2024: Synthetic 3-month sterling LIBOR is intended to cease. End-September 2024: The FCA has consulted on a proposal to require publication of a synthetic US dollar LIBOR for the 1-, 3- and 6-month settings until September 2024. The consultation sought views on this and also on the FCA's proposed synthetic methodology, and which contracts could use these synthetic settings. However, market participants should not rely on the availability of synthetic US dollar LIBOR and should note that any potential synthetic settings would only be a temporary bridge to appropriate alternative risk-free rates. The FCA expects to announce its final decision in late Q1 or early Q2 2023.		
BoE/ FCA/ PRA	Operational Resilience; Implementation of new requirements and expectations to strengthen operational resilience in the financial services sector following publication of final policy in March 2021	In-scope firms had until 31 March 2022 to operationalise the policy framework. These firms will then have a further period to show they can remain within their impact tolerances for each	H	N/A

		important business service. They must achieve this by 31 March 2025 at the latest.		
BoE/ FCA/ PRA	Oversight of Critical Third Parties (CTPs); The Bank, PRA and FCA published a joint Discussion Paper (DP) in July 2022. The aim of the DP was to inform future regulatory proposals relating to Critical Third Parties (particularly on technically complex areas, such as resilience testing) and to provide thought leadership from the Bank, PRA and FCA to UK cross-sectoral and international financial regulatory debates on CTPs. Subject to FSM Bill timetables, the supervisory authorities plan to consult on proposals relating to the oversight of Critical Third Parties in H2 2023	Consultation Paper planned for 2023.	H	Oct – Dec 2023
HMT	Review of the short selling regulation - including a Call for Evidence Repeal and replace the retained EU regulation of short selling to reduce burdens on market participants and ensure it is appropriate for UK markets	5 March 2023: Consultation closes	L	Timing Updated Jan/Mar 2023
HMT	Wholesale Markets Review; The Government introduced the Financial Services and Markets Bill on 20 July 2022. Subject to Parliamentary approval, the Bill will deliver the outcomes of the Wholesale Markets Review. The FCA consulted on improving equity markets (CP 22/12) in July 2022 and on the trading venue perimeter (CP 22/18) in September 2022. The FCA aim to publish the Policy Statements in Q1 and Q2 2023 respectively. The FCA plan to consult on changes to commodity position limits and the consolidated tape regime in Q2/Q3 2023. The FCA	Treasury consultation response published in March 2022. In July 2022 the Government introduced the Financial Services and Markets Bill which takes forward the most urgently needed WMR reforms. FCA Consultation Paper 22/12 on Improving Equity Secondary Markets published in July 2022. Publication of the Policy Statement in Q1 2023. FCA consultation on guidance on the trading venue perimeter published	L	Timing Updated Jul - Sep 2023 Oct – Dec 2023

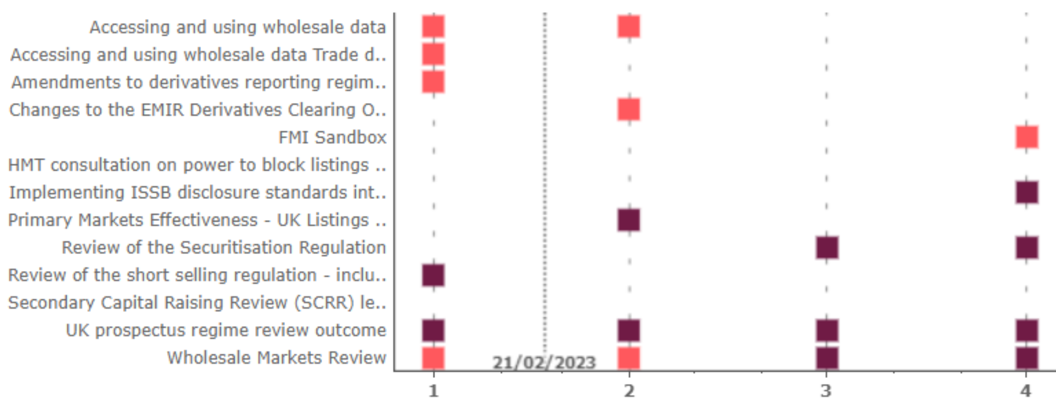
	intend to consult on the transparency regime for bonds and derivatives in Q4 2023. The Government consulted on a number of amendments to ensure that the UK's wholesale markets regime works for UK markets in July 2021 as part of the Wholesale Markets Review (WMR). The consultation closed in September 2021. In March 2022 the Government published its response to the consultation. The proposals we consulted on as part of the WMR that are a priority have been included in the Financial Services and Markets Bill. Where industry supported changes but indicated that fast implementation is not paramount, the Government will use the FRF powers to deliver them.	in September 2022. Publication of the Policy Statement in Q2 2023. FCA consultation on commodity derivatives and the consolidated tape in Q2/Q3 2023. FCA consultation on transparency for bonds and derivatives in Q4 2023.		
HMT (with input from	**Future financial services regulatory regime for cryptoassets – consultation;** In April 2022 the Economic Secretary to the Treasury set regulatory out ambitious plans for the UK to harness the benefits authorities) of crypto technologies with several commitments including consulting on a future regulatory regime. The Consultation Paper sets out our initial policy proposals for regulating cryptoassets in the UK. **UK regulatory approach to stablecoins;** Treasury consultation on the broader regulatory approach to cryptoassets, including new challenges from so-called stablecoins. Further detail on the regime will be communicated in due course.	01 February 2023: publication of Consultation Paper. The consultation will close on 30 April 2023. The Government has now responded to this consultation. The Government has now introduced legislation - the Financial Services and Markets Bill - that will give effect to the measure. Treasury is consulting on a future regulatory regime for cryptoassets (see 'Future regulatory regime for cryptoassets - consultation' under 'Payments and cryptoassets').	H	Timing Updated April / June 2023

BoE/ FCA/ HMT	FMI Sandbox; Legislation to create a Financial Market Infrastructure (FMI) sandbox was introduced in the FSM Bill 2022. The sandbox will support firms which want to use new technology, such as distributed ledger technology, to provide infrastructure services in financial markets. It ill enable a more flexible and tailored approach to meeting requirements in current legislation, whilst appropriately balancing any risks to financial stability, market integrity and consumer protection. Treasury have started work with the Bank of England and the FCA on secondary legislation to deliver this.	The Government has published information on this initiative as part of its response the Call for Evidence on the Wholesale and Investment uses of Security Tokens. The FMI Sandbox will be up and running in 2023.	L	Oct -Dec 2023 (Not updated)
BoE/ FCA/ HMT	Amendments to derivatives reporting regime under UK EMIR; The FCA and the Bank plan to finalise amendments to the derivatives reporting regime under UK EMIR to align the UK regime with international standards as set by the Committee on Payments and Market Infrastructures and International Organization of Securities Commissions (CPMI-IOSCO) to ensure a more globally consistent data set and improve data quality.	Consultation Paper setting out changes to reporting requirements, procedures for data quality and registration of Trade Repositories under UK EMIR published Q4 2021 (closed February 2022). Policy Statement, validation rules and schemas to be published in Q1 2023.	L	Timing Updated Jan/Mar 2023 and post July 2024
BOE	Changes to the EMIR Derivatives Clearing Obligation The Bank has modified the scope of contracts which are subject to the derivatives clearing obligation to reflect the reforms to interest rate benchmarks, including LIBOR. No further changes are planned to be announced, but the implementation of the final change announced in 2022 will come into effect in April 2023	Policy Statement on the changes L to USD interest rate derivatives published in August 2022. SOFR referencing IRS added 31 October 2022; USD LIBOR referencing IRS removed 24 April 2023	L	April / June 2023

FCA	Primary Markets Effectiveness - UK Listings Review response The FCA has bought forward consultation and discussion items on reforms to improve the effectiveness of UK primary markets, which follows FCA policy review work and responds to Lord Hill's final UK Listings Review Report and recommendations published on 3 March 2021.	Consultation Paper on special L E I purpose acquisition companies (SPACs) - published 30 April 2021 (CP21/10), closed 28 May 2021. Policy Statement on SPACs - published 27 July 2021 (PS21/10). Consultation Paper on further Listing Rule changes- published 6 July 2021 (CP21/21), closed 14 September 2021. Policy Statement on Listing Rules changes - published on 2 December 2021 (PS21/22). Discussion Paper (DP22/2) published 26 May 2022, closed on 28 July 2022. Potential Consultation Paper in Q2 2023, including feedback to DP22/2.	L	Timing Updated April / June 2023
FCA	**Implementing ISSB disclosure standards into FCA listing or transparency rules;** We expect the International Sustainability Standards Board to finalise international sustainability disclosure standards later in 2023. The FCA has previously indicated it will explore implementing those standards in its rules for listed companies once finalised, which would replace existing TCFD disclosure requirements. The FCA expects to consult towards the end of this year, with final rules in the first half of 2024 subject to feedback. Timing may be subject to the Government's response to the ISSB standards	Consultation Paper in Q4 2023 Policy Statement 2024	L	Oct -Dec 2023
HMT	Treasury consultation on power to block listings on national security grounds; This initial consultation asked for views on	This consultation closed on 27 August 2021. The Government responded to the consultation on 10	L	N/A

	the scope of a proposed new targeted power to allow the Government to block a company's listings, if a listing presents a risk to national security. This power will reinforce that reputation and help us maintain the UK's status as a world-class destination for listings	December 2021. This policy will require legislation to be enacted.However, more policy development is needed before that is possible. Treasury will continue to develop this power taking full account of the responses to this consultation		
HMT	UK prospectus regime review outcome; This initial consultation asked for views on the scope of a proposed new targeted power to allow the Government to block a company's listings, if a listing presents a risk to national security. This power will reinforce that reputation and help us maintain the UK's status as a world-class destination for listings.	The Government will legislate to replace the regime currently contained in the UK Prospectus Regulation following the passage of the Financial Services and Markets Bill.	L	All dates applicable
DBT/ HMT	Secondary Capital Raising Review (SCRR) led by Mark Austin; The SCRR is intended to look into improving further capital raising processes for publicly traded companies in the UK. The review was started in October 2021 and reported in July 2022. The Government has accepted all the recommendations addressed to it and is considering how to take these forward	The Government has accepted all the recommendations addressed to it and is considering how to take these forward	L	N/A
HMT	Review of the Securitisation Regulation; Treasury has met its legal obligation to review the Securitisation Regulation and lay a report before Parliament. Treasury, FCA and PRA taking forward work in areas identified in the report.	June - September 2021: Call for Evidence took place December 2021: Treasury report on the review published and laid in Parliament July 2022: Based on the review, an equivalence regime for nonUK Simple, Transparent and Standardised (STS) securitisations has been	L	Timing Updated Jul - Sep 2023 Oct – Dec 2023

		included in the FSM Bill 2022. December 2022: A draft SI has been published, intended to demonstrate how Treasury may implement the outcomes of the FRF review for the Securitisation Regulation. This process will enable reforms in areas identified in the report to be taken forward. 2023 and 2024: The FCA and the PRA will plan to consult on the FCA and PRA rules to deal with the relevant firm-facing provisions in the Securitisation Regulation (and related technical standards) taking into consideration the reform areas identified in Treasury's Review of the Securitisation Regulation. Treasury plans to lay legislation to enable the introduction of these rules.		



Regulatory Initiatives Grid overview

Regulatory Initiatives Grid Dashboard - Overview

Joint/individual led? (All)

Drilldown for Joint Initiatives (All)

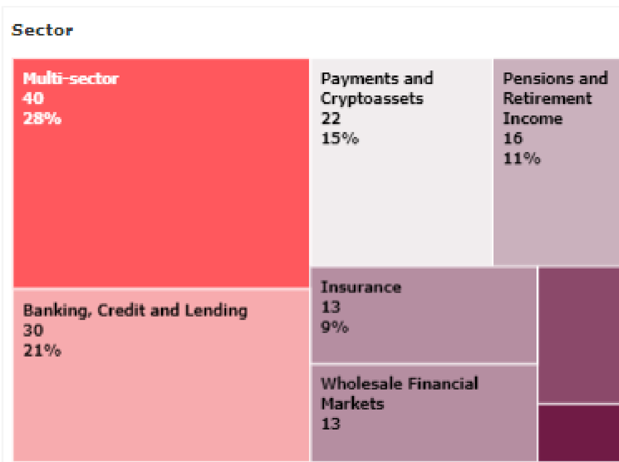
The drilldown filter is used in conjunction with **Joint / Individual led** filter. When selecting '**Joint initiatives**' (in that filter), use the drilldown to select which authorities you view.

Included in previous Grid? (All)

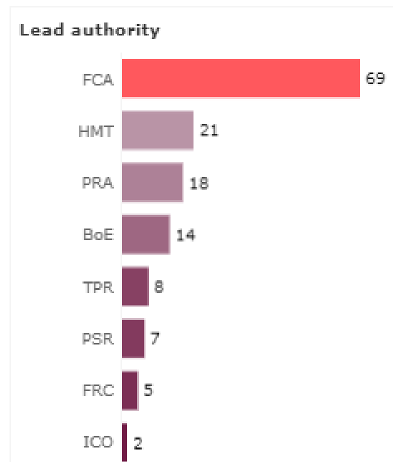
Consultation planned? (All)

The four visualisations below can be filtered by clicking on the segments. Clicking again will deselect them. To return the dashboard to default click the Reset/Revert.

Sector

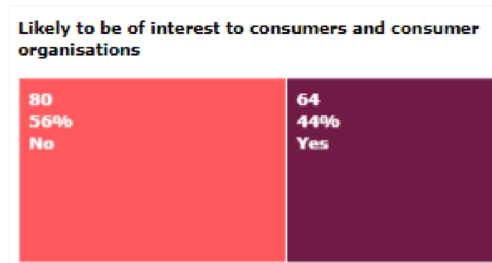


Lead authority



Indicative impact on firms

Likely to be of interest to consumers and consumer organisations



Please note: The timeline below is organised into quarters, except the last two date points. The penultimate date point covers a 6-month period (from the date label) and the final date point covers from that point onwards. Squares denoting actions will appear at the start of period for all actions planned within it.

Timeline date slider
2023 Q1 2024 Q3

Timeline legend
Engagement planned
Key milestone planned
No action planned

Feb 2023 Narrative; Rathi & Woods:

- The sixth edition of the Grid comes at a time of new horizons for the future of financial services regulation. At our last publication the Financial Services and Markets (FSM) Bill had only recently been announced. In the following months, we witnessed fast-paced developments in both the political and economic landscapes. Delaying the November 2022 Grid to now has allowed the regulators to better consider how the opportunities provided by the Edinburgh Reforms, including the Government's policy statement 'Building a Smarter Financial Services Framework for the UK', will impact the regulatory pipeline and initiatives over the coming years.
- Seizing new opportunities; Many of the concerns regulators were considering last May are still relevant today. The war in Ukraine continues and the financial sanctions regime

continues to evolve, firms and individuals are still experiencing cost of living pressures, and financial challenges in multiple sectors require collaborative efforts and support. There are therefore many initiatives that remain as relevant today as they were in the previous Grid. We are still working to increase consumer protections and enhance competition, value for money, and transparency at pace, while maintaining safety and soundness.

- However, when reflecting on the initiatives overall within the Grid, it is clear that regulators are using the prospect of a new framework outside of the EU as a chance to proactively move forward and deliver better outcomes for consumers and industry. This is being delivered both with new pieces of work (including the Edinburgh Reforms and the repeal and replacement of retained EU law to regulators' rulebooks) as well as new opportunities to reduce regulatory burdens.
- The key themes and measures from the Edinburgh Reforms and the FSM Bill are reflected in the Grid's commitments. Regulators are taking forward the Government's ambition for the UK to be an attractive, trusted and competitive global hub of financial services. The Grid contains more detail on many of the Edinburgh Reforms announced by the Chancellor last year including reforming the Ring-Fencing Regime for banks, consulting on removing burdensome customer information requirements set out in the Payment Accounts Regulations 2015 and overhauling the regulation of prospectuses.
- Initiatives such as the review of the Senior Managers and Certification Regime and ongoing work following Lord Hill's UK Listings Review Report should aim to preserve high standards alongside a refreshed regulatory focus on growth and competitiveness. Many of the new initiatives also enable better use of technology and innovation to ensure that the regulatory framework is fit to meet emerging challenges and opportunities (examples include consultations on rules for the stablecoin regime, the future regulatory regime for cryptoassets, and oversight of critical third parties). We will be reflecting in future iterations of the Grid the timings and impacts of any further changes under the Government's reforms as they are confirmed.
- The overall number of initiatives is broadly steady and has not significantly added to the level of regulatory burden. This reflects a steady increase in the number of initiatives regulators have completed or have moved into 'business as usual' for stakeholders, following delays resulting from Covid-19. We expect this trend to continue as further reforms are implemented. We will continue to closely monitor this and coordinate as we appreciate there are lots of significant changes in the pipeline as the Grid shows.
- Managing change; This edition of the Grid and upcoming editions will continue to reflect UK regulators' commitment to new ways of working following the UK's exit from the EU. Regulators will also continue to implement core initiatives such as delivery of relevant international standards like Basel 3.1. Managing this direction of travel means that Forum members recognise now more than ever the need to consider the pace and proportionality of our initiatives.
- The Government's policy statement setting out the approach to repealing and replacing retained EU law on financial services sets out an ambitious plan and Forum members will be supporting it. Progressing with the repeal of retained EU law in financial services and building a smarter regulatory framework will be a significant undertaking for both the regulators and the parts of the industry affected, and we will try to minimise the burden as this progresses.

- There are also specific initiatives in the Grid which we recognise may have a particularly high impact on some sectors, such as asset managers and payments providers. While welcomed by the sector, measures to prevent Authorised Push Payment (APP) Scams through Confirmation of Payee and improved intelligence sharing, and the increased number of initiatives relating to cryptoassets, will require significant collaboration between Government, regulators and industry to be successful.
- Regulators will continue to work with industry, organise together and use the Grid as an input to business planning, including considering whether milestones in the regulatory pipeline should be delayed or deferred to mitigate spikes in the operational burden on industry. We also intend in future editions to provide stakeholders with more information in the Grid about proposals for repeal of retained EU law, alongside wider initiatives.The current Regulatory Initiatives Grid | February 2023 2 pace of new initiatives in part reflects the many initiatives in the Grid that will simplify and reduce any unnecessary regulatory burden (including transforming data collection and a 'Strong and Simple' prudential framework for nonsystemic banks and building societies). The current picture showing a broadly steady number of overall initiatives as well as many initiatives being completed since the previous Grid will be monitored moving forward.
- Next steps; The FSM Bill is expected to receive Royal Assent this year, when Parliamentary time allows. We note that many of the regulatory initiatives set out in the Bill are already reflected in the Grid but we do expect subsequent Grids to provide further clarity on the subsequent timelines and milestones after Royal Assent.
- We also note that due to the delay to the publication of the sixth edition of the Grid, in order to consider the potential implications of the Edinburgh Reforms on the regulatory pipeline, we have received questions on the future schedule for Grid publications. The Forum remains committed to publishing two Grids per year where possible. This edition will be the first Grid of 2023 and the next will be published towards the end of the year. However, in recognition of the length of time between those publications, and the impact of the FSM Bill, the Forum will provide a short statement after Royal Assent informing the sector of any important and imminent changes.

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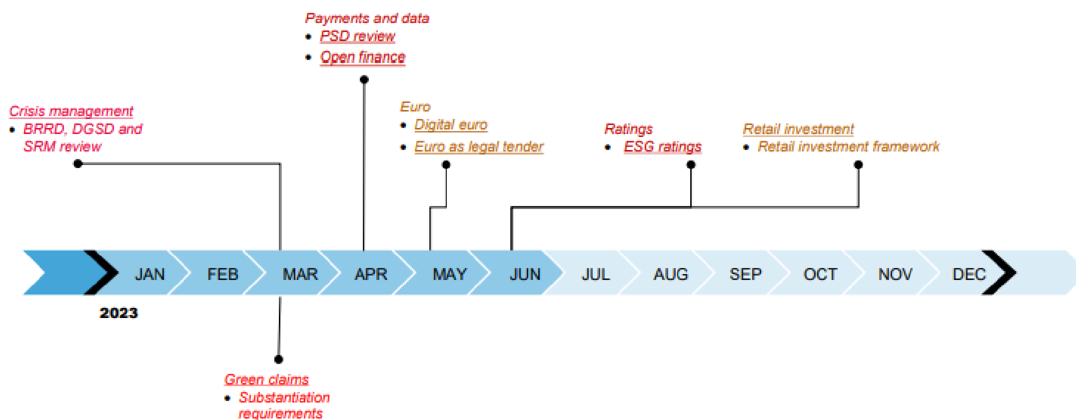
The European Commission continues to add to the pipeline but progress is slow on agreeing existing proposals.

- So far, the 2019-24 Commission has proposed 37 legislative acts on financial services and cross-cutting issues particularly relevant to financial services, of which the European Parliament and the Council have only agreed the text of 11 acts. The Parliament and the Council continue to work to agree the remaining 26 proposals and the Commission has scheduled eight additional proposals for the first half of 2023.
- Work to agree proposals in the pipeline will intensify in the lead up to the Parliament elections in mid-2024 and the new Commission taking office in October 2024.

THE EU FINANCIAL SERVICES LEGISLATIVE PIPELINE
LEGISLATIVE PROPOSALS SCHEDULED FOR H1 2023

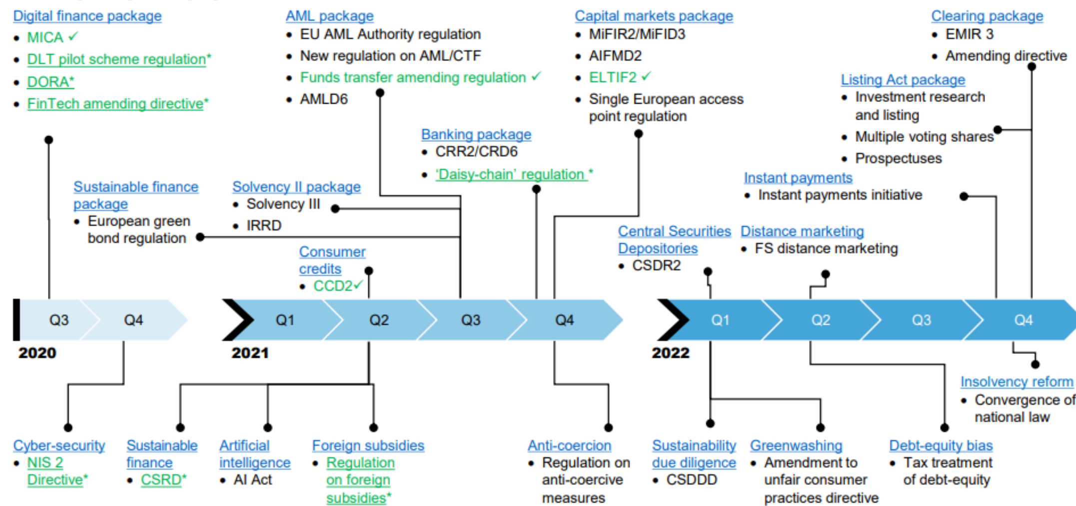
FINANCIAL SERVICES



CROSS-CUTTING

THE EU FINANCIAL SERVICES LEGISLATIVE PIPELINE
LEGISLATIVE PROPOSALS 2020-2022

FINANCIAL SERVICES



CROSS-CUTTING

Legislative Proposals On Financial Services Scheduled For H1 2023

Financial services

- 08/03/2022 Banking Union – review of the bank crisis management & deposit insurance framework (BRRD, DGSD, SRMR review)
  - Public consultation 25/02/2021
  - Targeted consultation 26/01/2021
- 05/04/2022 Retail investment – new package of measures to increase consumer participation in capital markets Call for evidence 03/05/2022

- 24/05/2022 A digital euro for the EU
  - Targeted consultation 14/06/2022
  - Call for evidence 05/04/2022
- 24/05/2022 Clarifying the legal tender status of euro banknotes and coins None
- 13/06/2022 Regulation on environmental, social and governance ratings Call for evidence 04/04/2022
- 28/06/2022 Payment services – review of EU rules
  - Public consultation 10/05/2022
  - Targeted consultation 10/05/2022
- 28/06/2022 Open finance framework – enabling data sharing and third-party access in the financial sector Public consultation 10/05/2022

Delayed And Possible Future Legislative Proposals On Financial Services

- Financial services Review of the Market Abuse Regulation (MAR) ESMA report 24/09/2020
- Review of the Directive on settlement finality in payment and securities settlement systems Targeted consultation 12/02/2021
- Review of the Directive on financial collateral arrangements Targeted consultation 17/02/2021
- Improving transparency of the secondary markets for non-performing loans Targeted consultation 16/06/2021
- EU banking sector – review of macroprudential rules to limit systemic risk Call for evidence 01/12/2021 Targeted consultation 30/11/2021
- Review of the Money Markets Funds Regulation ESMA opinion 16/02/2022 Targeted consultation 08/02/2022
- Review of the Benchmarks Regulation Targeted consultation 20/05/2022
- Mortgage credit – review of EU rules EBA advice 24/06/2022 Public consultation 22/11/2021
- Review of implementation of the Shareholders Rights Directive 2 (SRD2) Call for evidence 11/10/2022
- Review of the Regulation on wholesale market integrity and transparency (REMIT) Public consultation 23/01/2023
- Cross-cutting
- Cross-border investment within the EU – clarifying and supplementing EU rules Public consultation 26/05/2020
- Unlawful extra-territorial sanctions – a stronger EU response (amendment of the Blocking Statute) Public consultation 09/09/2021
- Corporate reporting – improving its quality and enforcement Call for evidence 01/12/2021
- Withholding taxes – new EU system to avoid double taxation Public consultation 01/04/2022

Pending Legislative Proposals On Financial Services

Banking package

- Proposal for a Directive amending the Capital Requirements Directive as regards supervisory powers, sanctions, thirdcountry branches, and environmental, social and governance risks (CRD6) (2021) 663 2021/0341 27/10/2021

- Proposal for a Regulation amending the Capital Requirements Regulation as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor (CRR3) (2021) 664 2021/0342 27/10/2021
- Proposal for a Regulation amending the Capital Requirements Regulation and the Bank Recovery and Resolution Directive as regards the prudential treatment of G-SIIs with a multiple point of entry resolution strategy and a methodology for the indirect subscription of instruments eligible for meeting MREL (daisy-chain regulation) (adopted – see Annex 4)

Capital Markets Package

- Proposal for a Directive amending the Markets in Financial Instruments Directive (MiFID3) (2021) 726 2021/0384 25/11/2021
- Proposal for a Regulation amending the Markets in Financial Instruments Regulation as regards enhancing market data transparency, removing obstacles to the emergence of a consolidated tape, optimising the trading obligations and prohibiting receiving payments for forwarding client orders (MiFIR2) (2021) 727 2021/0385 25/11/2021
- Proposal for a Directive amending the Alternative Investment Fund Managers Directive and the UCITS Directive as regards delegation arrangements, liquidity risk management, supervisory reporting, provision of depositary and custody services and loan origination by alternative investment funds (AIFMD2) (2021) 721 2021/0376 25/11/2021
- Proposal for a Regulation amending the European Long-term Investment Funds Regulation as regards the scope of eligible assets and investments, the portfolio composition and diversification requirements, the borrowing of cash and other fund rules and as regards requirements pertaining to the authorisation, investment policies and operating conditions of European longterm investment funds (ELTIF2) ✓ (2021) 722 2021/0377 25/11/2021
- Proposal for a Regulation on establishing a European single access point providing centralised access to publicly available information of relevance to financial services, capital markets and sustainability (2021) 723 2021/0378 27/11/2021

Clearing package

- Proposal for a Regulation amending the Central Securities Depository Regulation (CSDR2) (2022) 120 2022/0074 16/3/2022
- Proposal for a Regulation amending EMIR, the Capital Requirements Regulation and the Money Markets Funds Regulation as regards measures to mitigate excessive exposures to third-country central counterparties and improve the efficiency of Union clearing markets (2022) 697 2022/0403 07/12/2022

Forward Calendar: Updated 01 March 2023		
H12023	Australia	Expected finalization of APRA FRTB and CVA risk (APS 116 and APS 180) frameworks
H1 2023	Australia	Expected third consultation paper on over-the-counter (OTC) derivatives reporting and technical guidance by ASIC. Expected publication of final OTC derivatives reporting rules by ASIC
Q1 2023	Singapore	Expected publication of the updated MAS reporting regime; delay from originally indicative Q2 2022 timeline.

Q1 2023	EU	New application date for the leverage ratio surcharge for G-SIIs in the EU as agreed in the CRR quick fix legislation finalised in June 2020.
Q1 2023	EU	Application of the Regulatory Technical Standards (RTS) under the Sustainable Finance Disclosure Regulation including disclosures for use of ESG-linked derivatives (except from first detailed reporting on the principal adverse impact indicators due by June 30, 2023).
Q1 2023	EU	From 2023, the disclosure requirement under Regulation EU 2020/852 on the establishment of a framework to facilitate sustainable investment ('EU Taxonomy') with respect to the environmental objectives 'the sustainable use and protection of water and marine resources', 'the transition to a circular economy', 'pollution prevention and control' and 'the protection and restoration of biodiversity and ecosystem' (Article 9 (c) -(f)) have to be applied
March 01, 2023	South Africa	Three-month calculation period begins to determine whether the average aggregate notional amount of derivatives for an entity and its affiliates exceeds the ZAR 15 trillion threshold for initial margin requirements as of September 1, 2023 (per amended rule pending finalization). Variation margin requirements commence for any provider belonging to a group with aggregate month-end gross notional amount of over-the-counter derivatives for March, April and May of 2020 exceeding R30 trillion
March 01, 2023	US EU Australia Canada Hong Kong Korea Switzerland Singapore Japan South Africa	Three-month calculation period begins to determine whether the average aggregate notional amount of derivatives for an entity and its affiliates exceeds the lowest threshold for application or revocation of initial margin requirements as of the next relevant compliance date of either September 1, 2023 or January 1, 2024 (EU/UK/CHF/US Prudential). In the US, this calculation period only applies under CFTC regulations. For RSA, Three-month calculation period begins to determine whether the average aggregate notional amount of derivatives for an entity and its affiliates exceeds either the ZAR 15 trillion or ZAR 8 trillion threshold for initial margin requirements as of September 1, 2023. (per amended rule pending finalization).
March 15, 2023	Singapore	Circular published to banks on the implementation of the final Basel III reforms and reporting schedules for submission via its data collection gateway. Version 1.0 submission pack is due mid-March 2023.
March 20, 2023	China	The China Banking and Insurance Regulatory Commission and the People's Bank of China have issued a public consultation due on March 20, 2023 on the 'Measures for the Administration of Capital of Commercial Banks'. This is meant to further improve capital regulatory rules of commercial banks, promote banks to improve their risk management level, and improve the quality and efficiency of banks in serving the real economy.
March 31, 2023	Japan	Basel III: Implementation of leverage buffer for G-SIBs (certain transitional arrangement will apply until March 31, 2024, and some change will become effective from April 1, 2024)

Q2 2023	EU	The European Commission (EC) to adopt a Delegated Act (DA) to further extend the suspension of the third-country benchmark regime until end of 2025 under the EU Benchmarks Regulation (BMR).
Q2 2023	Hong Kong	Consultation of Hong Kong's reporting rules on adoption of UPI and CDE.
April 24, 2023	UK	Removal of clearing obligation for swaps referencing SOFR.
April 28, 2023	EU	The European Supervisory Authorities (ESAs) to submit a report to the European Commission (EC) on the broader SFDR RTS review (including on Principal Adverse Impact indicators)
May 1, 2023	India	Variation margin requirements apply to domestic covered entities exceeding the AANA threshold of INR 250 billion (approximately USD 3.2 billion)
June 2023	UK	Deadline for ending reliance on US dollar LIBOR.
June 1, 2023	US	Three-month calculation period begins under US prudential regulations to determine whether the material swaps exposure, or daily average aggregate notional amount, of swaps, security-based swaps, FX swaps and FX forwards for an entity and its affiliates that trade with a prudentially regulated swap dealer exceeds $8 billion for the application of initial margin requirements as of January 1, 2024
June 15, 2023	EU	The European Commission shall adopt a Delegated Acts (DA) to designate exempted FX spot rates from the scope of the EU BMR.
June 15, 2023	EU	The European Commission (EC) shall submit a report to the European Parliament and to the Council on the scope of the BMR, in particular with respect to the use of third country benchmarks. If appropriate, the EC shall accompany the report with a legislative proposal.
June 18, 2023	UK	End of the temporary exemption for pension scheme arrangements from clearing and margining under UK EMIR.
June 18, 2023	EU	End of the temporary exemption for pension scheme arrangements from clearing and margining under EU EMIR.
June 28, 2023	EU	As part of CRR II, the European Banking Authority is to report on the calibration of the Standardised Approach for Counterparty Credit Risk (SA-CCR) which will potentially inform a future review by the European Commission.
June 28, 2023	EU	As part of CRR II, the European Banking Authority is to report on the treatment of repos and reverse repos as well as securities hedging in the context of the Net Stable Funding Ratio (NSFR).
Q3 2023	EU	The EC shall adopt Delegated Acts (DAs) to specify the technical screening criteria with respect to the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control and the protection and restoration of biodiversity and ecosystem.

Q3 2023	EU	The European Commission (EC) has published the 3rd Capital Requirements Regulation (CRR III) proposal on October 27, 2021, which will implement the Basel 3 framework in Europe. The CRR III will transpose the market risk standards (FRTB) as a binding capital constraint, the output floor, the revised credit valuation adjustment framework, alongside operational and credit risk framework, amongst others. The proposal will also take into consideration the impact of the COVID-19 crisis on the EU banking sector. Member States reached their General Approach on November 8, 2022, and the European Parliament is expected to adopt its position on January 24, 2023. That means trilogues will likely start in February/March 2023 and it is expected the CRR 3 process will be finalized in Q3 2023. From the EC's original proposal, most of the requirements are set to apply from January 1, 2025. As a result of the ongoing negotiations, the implementation date of January 1, 2025, may still be subject to change
July 1, 2023	US	CFTC Effective Date for the Clearing Rules to Account for the Transition from LIBOR (See 87 Fed. Reg. 52182 (August 24, 2022)). The portion of the rule effective on this date removes the requirement to clear interest rate swaps referencing US dollar LIBOR and the Singapore Dollar Swap Offer Rate in each of the fixed-to-floating swap, basis swap and FRA classes, as applicable.
July 31, 2023	US	Expiration of a second extension of relief to Shanghai Clearing House permitting it to clear swaps subject to mandatory clearing in the People's Republic of China for the proprietary trades of clearing members that are US persons or affiliates of US persons (CFTC Letter No. 22-07).
Q3/ Q4 2023	EU	Earliest expected start date for the Internal Model Approach (IM) reporting requirements under the CRR II market risk standard.
September 1, 2023	US EU Australia Canada Hong Kong Korea Switzerland Singapore Japan	Under CFTC rules only, initial margin requirements apply to covered swap entities with material swaps exposure (average aggregate daily notional amount exceeding USD 8 billion). Initial margin requirements apply to Phase 6 APRA covered entities with an aggregate notional amount exceeding AUD 12 billion. Canada: Under both OSFI and AMF guidelines, initial margin requirements apply to Phase 6 covered entities with aggregate month-end average notional amount exceeding CAD 12 billion. Hong Kong: Initial margin and risk mitigation requirements apply to HKMA AIs and SFC LCs with an aggregate notional amount exceeding HKD 60 billion. Korea: Initial margin requirements apply to financial institutions with derivatives exceeding more than KRW 10 trillion. Singapore: Initial margin requirements apply to MAS covered entities with an aggregate notional amount exceeding SGD 13 billion. Japan: Initial margin requirements apply to JFSA covered entities with an aggregate notional amount exceeding JPY 1.1 trillion. Brazil: Initial margin requirements apply to financial institutions and other entities authorized to operate by the Central Bank of Brazil which have an average aggregate notional amount exceeding BRL 25 billion.

September 1, 2023	South Africa	Initial margin requirements apply to a provider with aggregate month-end average notional amount exceeding ZAR 8 trillion. South Africa; Initial margin requirements apply to a provider with aggregate month-end average notional amount exceeding either ZAR 15 trillion or ZAR 8 trillion.
December 04, 2023	US	Swap data repositories (SDRs), swap execution facilities (SEFs), designated contract markets (DCMs), and reporting counterparties must comply with the amendments to the CFTC swap data reporting regulations found in Part 43, Part 45 and Part 49 by the compliance date of December 5, 2022; provided, however that SDRs, SEFs, DCMs, and reporting counterparties must comply with the amendments to §§43.4(h) and 43.6 by December 4, 2023.
December 04, 2023	US	Compliance date for CFTC Block and Cap reporting amendments. Expiry of relief in CFTC Staff Letter No. 22-03.
December 31, 2023	EU	The amended Benchmarks Regulation that entered into force on February 13, 2021 extends the BMR transition period for non-EU benchmark administrators until December 31, 2023 and empowers the European Commission (EC) to adopt a delegated act by June 15, 2023 to prolong this extension by maximum two years until December 31, 2025. It also enables the EC to adopt delegated acts by June 15, 2023 in order to create a list of spot foreign exchange benchmarks that will be excluded from the scope of Regulation (EU) 2016/1011.
December 31, 2023	UK	Expiry of the temporary Intragroup Exemption Regime (TIGER) from clearing and margin requirements.
2024 / 2025	Singapore	MAS will defer implementation of the final Basel III reforms in Singapore between January 1, 2024 and January 1, 2025 to allow the industry sufficient time for proper implementation of systems needed to adopt the revised framework, including regulatory reporting. This aligns timelines with other major jurisdictions. MAS will monitor banks' implementation progress and finalize the implementation timeline for the final Basel III reforms, including the transitional arrangement for the output floor by July 1, 2023
January 1, 2024	US EU Switzerland UK	Under US Prudential Regulations only, initial margin requirements apply to covered swap entities with material swaps exposure (average aggregate daily notional amount exceeding USD 8 billion). EU: Initial margin requirements apply to counterparties with an aggregate average notional amount exceeding EUR 8 billion. Switzerland: Initial margin requirements apply to counterparties whose aggregate month-end average position exceeds CHF 8 billion. UK: Initial margin requirements apply to counterparties with an aggregate average notional amount exceeding EUR 8 billion.
January 1, 2024	Australia	Basel III: Expected implementation of FRTB framework.

January 1, 2024	EU	Application of the Delegated Acts (DAs) with respect to the four remaining environmental objectives on the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control and the protection and restoration of biodiversity and ecosystem.
January 1, 2024	EU	Disclosure of Article 8 Taxonomy reporting KPIs and accompanying information for financial undertakings.
January 1, 2024	Hong Kong	Basel III: Locally incorporated AIs required to report under revised FRTB and CVA frameworks.
January 1, 2024	Hong Kong	Basel III: Expected implementation of revised credit risk, operational risk, output floor, and leverage ratio frameworks
January 2024	Australia	Expected effective date of APRA prudential standard for IRRBB (APS 117).
January 4, 2024	EU	The three-year derogation from margin rules in respect of non-centrally cleared over-the-counter derivatives, which are single-stock equity options or index option where no EMIR Article 13(2) equivalence determination is in place, was due to expire on January 4, 2021.
January 4, 2024	Hong Kong	Expiry of the SFC exemption from margin requirements for non-centrally cleared single stock options, equity basket options and equity index options.
January 4, 2024	UK	Expiry of the derogation from margin rules in respect of non-centrally cleared over-the counter derivatives, which are single-stock equity options or index options.
January 29, 2024	US	Compliance Date for registered entities and swap counterparties to use the Unique Product Identifier (UPI) for swaps in the credit, equity, foreign exchange and interest rate asset classes for P43 and P45 reporting.
February 12, 2024	EU	CCP R&R (Article 96): ESMA shall assess the staffing and resources needs arising from the assumption of its powers and duties in accordance with this Regulation and submit a report to the European Parliament, the Council and the Commission.
March 01, 2024	Australia US EU Australia Canada Hong Kong Korea Switzerland Singapore Japan Brazil	Three-month calculation period begins to determine whether the average aggregate notional amount of derivatives for an entity and its affiliates exceeds the lowest threshold for application or revocation of initial margin requirements as of the next relevant compliance date of either September 1, 2024 or January 1, 2025 (EU/UK/CHF/US Prudential). In the US, this calculation period only applies under CFTC regulations.
March 01, 2024	South Africa	Three-month calculation period begins to determine whether the average aggregate notional amount of derivatives for an entity and its affiliates exceeds ZAR 8 trillion threshold for initial margin requirements as of September 1, 2024 (per amended rule pending finalization)..

March 31, 2024	Japan	Basel III: Implementation of revised credit risk, CVA, market risk (FRTB) for international active banks and domestic banks using IMM.
April 01, 2024	Japan	Go-live of revised JFSA reporting rules based on the CPMI-IOSCO Technical Guidance. JFSA finalized the Guidelines of the revised reporting rules on December 9, 2022.
April 01, 2024	India	The RBI published draft guidelines on minimum capital requirements for market risk as part of convergence with Basel III standards. Applicable to all commercial banks excluding local area banks, payment banks, regional rural banks, and small finance banks. Not applicable to cooperative banks.
April 29, 2024	EU	Go-live of EMIR Refit reporting rules
June 28, 2024	EU	As part of the review clause inserted in CRR II, the European Commission taking into account the reports by the European Banking Authority is expected to review the treatment of repos and reverse repos as well as securities hedging transactions through a legislative proposal.
June 28, 2024	EU	As part of CRR II, the European Banking Authority is to monitor and report to the European Commission on Required Stable Funding (RSF) requirements for derivatives (including margin treatment and the 5% gross-derivative liabilities add-on).
June 30, 2024	EU	The EC to review the application of the Article 8 Taxonomy Regulation including the need for further amendments with regards to the inclusion of derivatives in the numerator of KPIs for financial undertakings.
September 1, 2024	Australia US EU Australia Canada Hong Kong Korea Switzerland Singapore Japan Brazil South Africa	Under CFTC rules only, initial margin requirements apply to covered swap entities with material swaps exposure (average aggregate daily notional amount exceeding USD 8 billion). Australia: Initial margin requirements apply to Phase 6 APRA covered entities with an aggregate notional amount exceeding AUD 12 billion. Canada: Under both OSFI and AMF guidelines, initial margin requirements apply to Phase 6 covered entities with aggregate month-end average notional amount exceeding CAD 12 billion. Hong Kong: Initial margin and risk mitigation requirements apply to HKMA AIs and SFC LCs with an aggregate notional amount exceeding HKD 60 billion. Korea: Initial margin requirements apply to financial institutions with derivatives exceeding more than KRW 10 trillion. Singapore: Initial margin requirements apply to MAS covered entities with an aggregate notional amount exceeding SGD 13 billion. Japan: Initial margin requirements apply to JFSA covered entities with an aggregate notional amount exceeding JPY 1.1 trillion. Brazil: Initial margin requirements apply to financial institutions and other entities authorized to operate by the Central Bank of Brazil which have an average aggregate notional amount exceeding BRL 25 billion. SA: Initial margin requirements apply to a provider with aggregate month-end average notional amount exceeding ZAR 8 trillion (per amended rule pending finalization).

September 1, 2024	South Africa	Initial margin requirements apply to a provider with aggregate month-end average notional amount exceeding ZAR 8 trillion (per amended rule pending finalization).
Q4 2024	Australia	Expected implementation of ASIC Derivative Transaction Rules (Reporting) 2024.
Q4 2024	Singapore	Expected go-live of the updated MAS reporting regime.
October 1, 2024	US	Expiration of temporary CFTC relief regarding capital and financial reporting for certain non-US nonbank swap dealers (See CFTC Staff Letter No. 22-10 and CFTC Staff Letter No. 21-20) *relief would also expire upon the Commission's issuance of comparability determinations for the jurisdictions in question.
October 21, 2024	Australia	Expected implementation of ASIC Derivative Transaction Rules (Reporting) 2024.
December 31, 2024	UK	The FCA direction under the temporary transitional powers allowing UK firms to execute certain trades with EU clients on EU venues (even though there is no UK equivalence decision in respect of those venues) expires at the end of 2024
January 1, 2025	EU	Expected implementation of FRTB and CVA risk under the CRR III proposal.
January 1, 2025	Australia	Basel III: Expected implementation of APRA FRTB and CVA risk (APS 116 and APS 180) frameworks.
March 1, 2025	South Africa	Three-month calculation period begins to determine whether the average aggregate notional amount of derivatives for an entity and its affiliates exceeds ZAR 100 billion threshold for initial margin requirements as of September 1, 2025 (per amended rule pending finalization)
March 31, 2025	Japan	Basel III: Expected implementation of revised credit risk, CVA, market risk (FRTB) for domestic banks not using IMM.
June 30, 2025	EU	The temporary recognition of UK CCPs (LME, ICE and LCH) under the EMIR 2.2 framework expires. Unless further addressed, following this date, EU firms could not have access to the UK CCPs and would need to relocate their clearing activities to EU CCPs. Under EMIR 2.2, ESMA has also performed its tiering assessment, with LME becoming a Tier 1 CCP whereas ICE and LCH are considered Tier 2 CCPs.
Q4 2024/Q1 2025	EU	Earliest expected start date for the Internal Model Approach (IM) reporting requirements under the CRR II market risk standard.
January 1, 2025	Australia	Basel III: Expected implementation of APRA FRTB and CVA risk (APS 116 and APS 180) frameworks.
January 1, 2025	UK	Expected implementation of the Basel 3.1 standards
March 31, 2025	Japan	Basel III: Expected implementation of revised credit risk, CVA, market risk (FRTB) for domestic banks not using IMM.

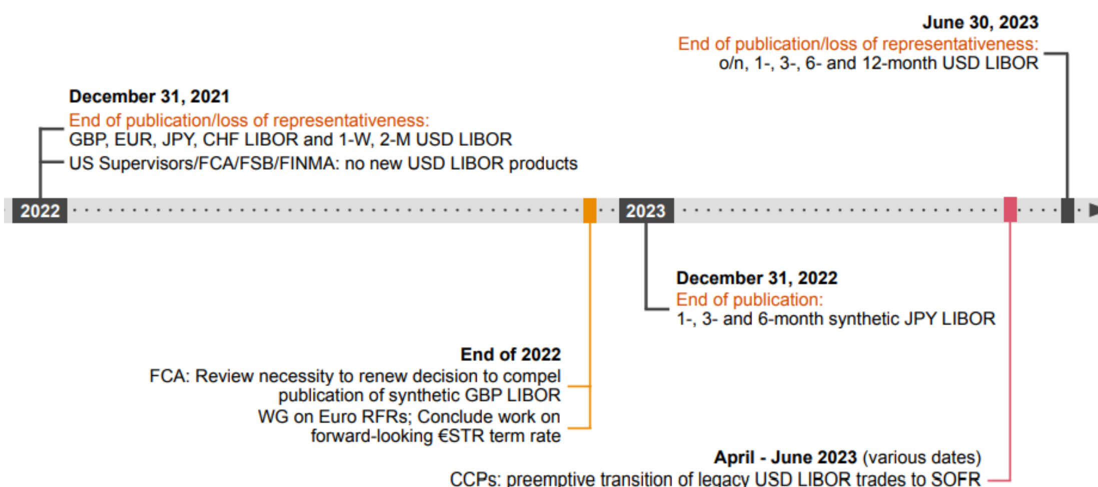
June 30, 2025	EU	The temporary recognition of UK CCPs (LME, ICE and LCH) under the EMIR 2.2 framework expires. Unless further addressed, following this date, EU firms could not have access to the UK CCPs and would need to relocate their clearing activities to EU CCPs. Under EMIR 2.2, ESMA has also performed its tiering assessment, with LME becoming a Tier 1 CCP whereas ICE and LCH are considered Tier 2 CCPs.
June 30, 2025	EU	The temporary exemption from clearing and margin requirements for cross-border intragroup transactions under EMIR expires.
September 1, 2025	South Africa	Initial margin requirements apply to a provider with aggregate month-end average notional amount exceeding ZAR 100 billion (per amended rule pending finalization).
November 15, 2025	EU	The CRR 2 IMA reporting requirements for market risk will be applicable from November 15, 2025, in the EU. As things stand currently in the CRR 3 political process, these IMA reporting requirements may become obsolete as we are still looking at a January 1, 2025, start date for the capitalization of market risk in the EU. However, IMA Reporting could still become live if the European Commission decides to enact the two-year delay mentioned under the CRR3 Article 461a FRTB delegated act. As this may still evolve in the CRR 3 negotiations, ISDA will keep monitoring developments in this area.
December 1, 2025	US	Expiry of extension of relief concerning swap reporting requirements of Part 45 and 46 of the CFTC's regulations, applicable to certain non-US swap dealers (SD) and major swap participants (MSP) established in Australia, Canada, the European Union, Japan, Switzerland and the United Kingdom, that are not part of an affiliated group in which the ultimate parent entity is a US SD, US MSP, US bank, US financial holding company or US bank holding company. See CFTC Staff Letters No. 20-37 and No. 22-14.
January 1, 2026	Australia	Basel III: Expected implementation of APRA FRTB and CVA risk (APS 116 and APS 180) frameworks.
February 12, 2026	EU	CCP R&R (Article 96): The European Commission (EC) shall review the implementation of this Regulation and shall assess at least the following: • the appropriateness and sufficiency of financial resources available to the resolution authority to cover losses arising from a non-default event • the amount of own resources of the CCP to be used in recovery and in resolution and the means for its use • whether the resolution tools available to the resolution authority are adequate. Where appropriate, that report shall be accompanied by proposals for revision of this Regulation.
June 2026	EU	Commodity dealers as defined under CCR, and which have been licensed as investment firms under MiFID 2/ MIFIR have to comply with real capital/large exposures/liquidity regime under Investment Firms Regulation (IFR) provisions on liquidity and IFR disclosure provisions.

August 12, 2027	EU	CCP R&R (Article 96): The Commission shall review this Regulation and its implementation and shall assess the effectiveness of the governance arrangements for the recovery and resolution of CCPs in the Union and submit a report thereon to the European Parliament and to the Council, accompanied where appropriate by proposals for revision of this Regulation.

LiBOR Transition

Table 1: timeline of events relating to derivative products referencing USD benchmarks	
01 May 2022	• CFTC introduces US swap clearing requirement on OIS referencing SOFR
31 October 2022	• Bank introduces DCO on OIS referencing SOFR
24 April 2023	• CCPs to commence removal of contracts referencing USD LIBOR as eligible for clearing • Bank removes contracts referencing USD LIBOR from DCO • Proposal: FCA removes contracts referencing USD LIBOR from DTO
01 July 2023	• Most widely used USD LIBOR benchmarks to cease publishing • CFTC removes contracts referencing USD LIBOR from US swap clearing requirement

Specification	Variables
Trade start type	Spot (T+2), IMM (next two IMM dates)
Tenor	2, 3, 4, 5, 6, 7, 10, 12, 15, 20, 30Y
Floating leg reference index	USD LIBOR 3M, USD LIBOR 6M



ClarusFT; Why Did SOFR Trading Decrease In January? Chris Barnes; 13Feb2023

- The ISDA-Clarus RFR Adoption Indicator declined to 51.1% last month.
- This is the sixth consecutive month that it has remained around 51%.
- SOFR adoption dropped from 64.1% to 58.5%.
- €STR adoption remains volatile, around 18-22% each month.

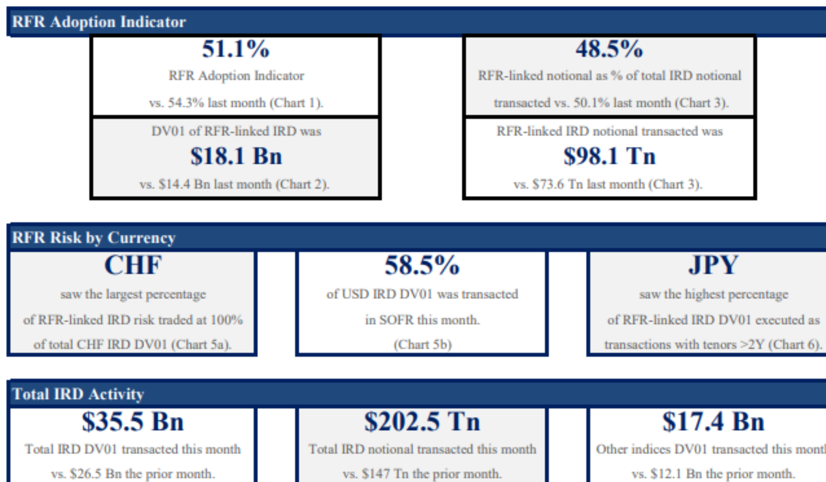
- I take a look at Fed Funds activity again in USD markets.

The ISDA-Clarus RFR Adoption Indicator for January 2023 has now been published.

ISDA-Clarus RFR Adoption Indicator

January 2023

ISDA-Clarus RFR Adoption Indicator tracks how much global trading activity (as measured by DV01) is conducted in cleared over-the-counter (OTC) and exchange-traded interest rate derivatives (IRD) that reference the identified risk-free rates (RFRs) in six major currencies.



RFR Adoption Indicator

51.1%
RFR Adoption Indicator
vs. 54.3% last month (Chart 1).

DV01 of RFR-linked IRD was
$18.1 Bn
vs. $14.4 Bn last month (Chart 2).

48.5%
RFR-linked notional as % of total IRD notional transacted vs. 50.1% last month (Chart 3).

RFR-linked IRD notional transacted was
$98.1 Tn
vs. $73.6 Tn last month (Chart 3).

RFR Risk by Currency

CHF
saw the largest percentage of RFR-linked IRD risk traded at 100% of total CHF IRD DV01 (Chart 5a).

58.5%
of USD IRD DV01 was transacted in SOFR this month.
(Chart 5b)

JPY
saw the highest percentage of RFR-linked IRD DV01 executed as transactions with tenors >2Y (Chart 6).

Total IRD Activity

$35.5 Bn
Total IRD DV01 transacted this month vs. $26.5 Bn the prior month.

$202.5 Tn
Total IRD notional transacted this month vs. $147 Tn the prior month.

$17.4 Bn
Other indices DV01 transacted this month vs. $12.1 Bn the prior month.

Showing;

- The index has dropped from 54.3% to to **51.1%** – very similar levels to where it has been for six months now.
- SOFR adoption retreated back to November/December levels at 58.5%, a surprising drop from last month's 64.1% reading.
- 48% of total activity by notional was vs RFRs, again at similar levels to the past 3 months.
- Futures activity again accounted for about 40% of all RFR risk – no real change since September last year.

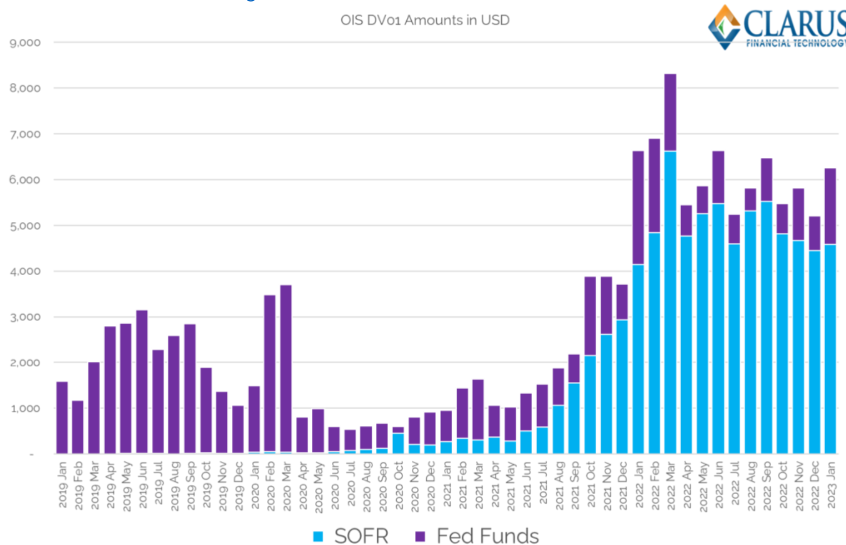
Why The Stasis? - Am I becoming a broken record? In the past few weeks, I have written:

- RFR Adoption – Is This Groundhog Day?
- Can $62Trn really be about to simply disappear?
- Are Fed Funds the latest winner from benchmark reform?

All of those blogs are very much about the slower than required adoption of RFRs, particularly SOFR, as June 2023 fast approaches. What does this tell us?

- That LIBOR cessation in USD, despite it being a much much larger market, appears to be progressing in a similar manner as it did for GBP, CHF and JPY.
- Markets love leaving things to the last minute.
- It continues to be very hard to change trading behaviour.
- Market participants will heavily rely on the conversion processes at CCPs to transition trades into SOFR.
- And finally, could it mean that the average holding period of a position is only about 3 months, so everyone will be terminating their LIBOR trades before June anyway?!

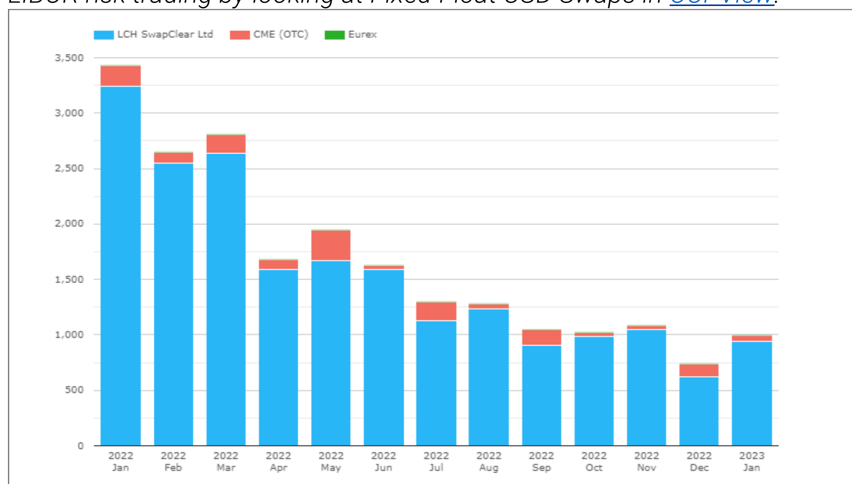
Fed Funds Trading is Hot Right Now; My previous blog, and other commentators, have noticed that Fed Funds volumes are really elevated at the moment (as they were in Q1 2022). Updating my most recent Fed Funds blog;



Showing;

- **DV01 Amounts** of USD OIS cleared each month for the past four years.
- These are OTC DV01 amounts only – i.e. they exclude futures.
- The SOFR market has been larger, in terms of DV01 traded, than Fed Funds for quite some time.
- In fact, the last time that more Fed Funds risk traded in OIS markets than SOFR was way back in July 2021!
- Why are we looking at Fed Funds risk AGAIN then? Because Fed Funds counts as a "legacy rate" in the RFR Adoption Indicator. Increases in Fed Funds risk therefore increases the "non-RFR" volumes that we monitor – and is also potentially taking volume away from SOFR, so is certainly relevant.
- Last month saw $6.25Bn DV01 traded in OIS, with FedFunds the highest since Mar 2022
- It helps explain what dragged SOFR trading down to 58.5% of the market again.

USD LIBOR Risk Increased in January 2023; *Staying in OTC space, we can monitor the amount of new USD LIBOR risk trading by looking at Fixed-Float USD Swaps in CCPView:*

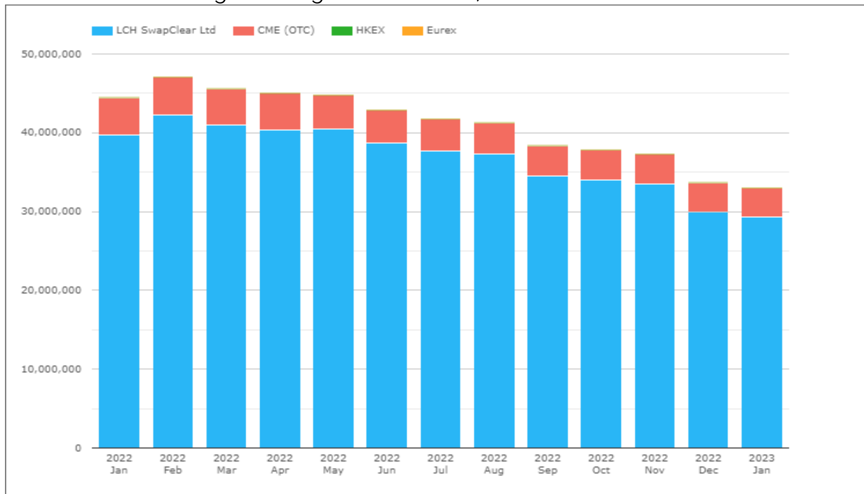


USD FixedFloat (Libor) Dv01 in millions

Showing;

- DV01 of USD LIBOR IRS cleared each month.

- Notice that $1bn of DV01 traded in LIBOR swaps – similar to the amount in Fed Funds last month!
- That was up from $735m last month, and similar to each of Sep, Oct and Nov last year.
- Could this be more LIBOR risk moving into clearing to benefit from the conversion process I wonder?
- Open Interest (measured by notional, not DV01) dropped a touch by end Jan 2023, though at $33 trillion single-side gross notional, there is a lot of stock to convert to SOFR.

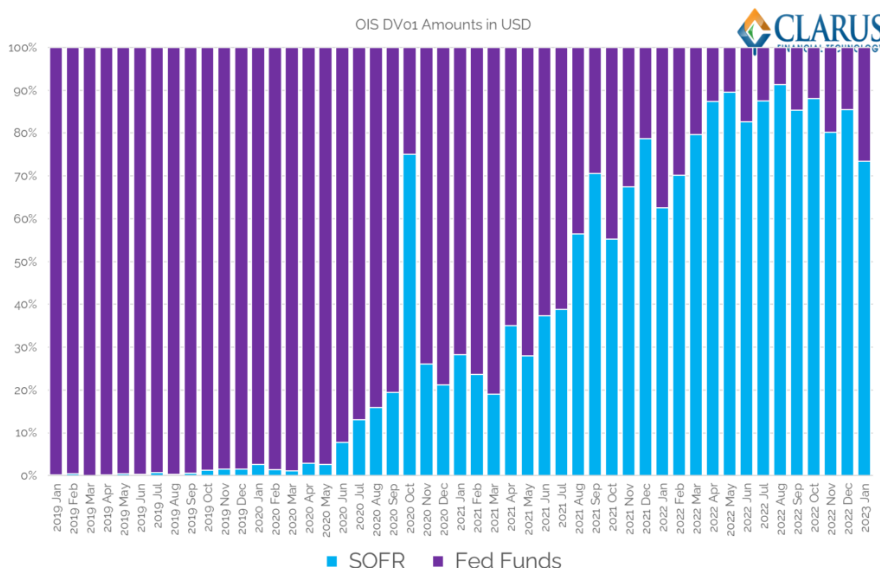


USD FixedFloat (Libor) Open Interest in usd millions

- Now it is not unusual for Open Interest (in notional terms) to reduce at year-end before "miraculously" rebounding in January. Did I hear anyone say Window Dressing?
- As far as I can tell, Open Interest has reduced in December and rebounded in January every year since at least 2018. Can't be a coincidence, right?
- Except for Jan 2023.

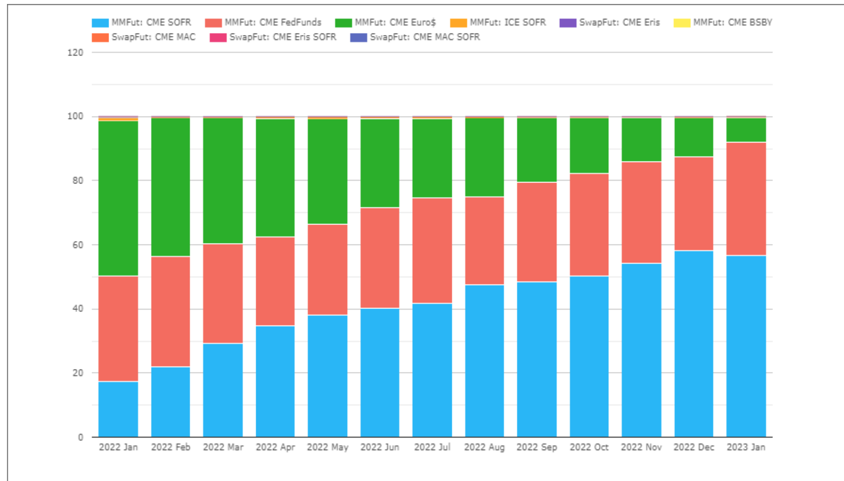
Two Final Charts

- Two final charts today that I think our readers will find interesting. The percentage of OIS risk that is traded as either SOFR or Fed Funds in USD OTC markets:



- I have previously stated that I thought around 10% of the USD market would be traded versus Fed Funds after LIBOR cessation. That was based on a pretty steady reading from Q2 and Q3 last year. It will be interesting if Q1 this years ends up looking like Q1 last year….

- And finally, let's not leave Futures out of this. The amount of DV01 risk trading in Eurodollar futures has shrunk to less than 10% of the total USD risk at CME:



ETD percentage share in dv01 terms

- With SOFR accounting for 57% of DV01 risk in Futures for Jan 2023 and FedFunds 35%, you can see that the story is very similar across both OTC and ETD. Fed Funds trading increased slightly last month, whilst USD LIBOR trading increased in OTC but not ETD.

In Summary

- January 2023 was not a great month for RFR Adoption.
- The headline indicator decreased to 51.1%.
- USD SOFR trading decreased to 58.5% of the market.
- Much of the trading outside of SOFR can be traced to increases in Fed Funds activity

3 Banks Get Initial OKs For $48M Deal In Libor-Rigging Case; A New York federal judge on Wednesday gave his initial approval to three settlements totaling nearly $48 million between investors and Credit Suisse and two other investment banks accused of manipulating the Swiss franc London Interbank Offered Rate. 📎4 documents attached | Read full article »

ESMA Consultation on authorisation and registration of benchmark administrators :; *The RTS needs to change to reflect the changes made to the RTS on the recognition regime introduced in the final report on the review of the RTS on recognition to ensure an equal treatment of EU based vs third country-based administrators.*

- ESMA is suggesting requesting additional information or further specifying some of the information already requested in the existing RTS in order to allow National Competent Authorities (NCAs) and ESMA to properly assess whether the applicant has established all the necessary arrangements to meet the requirements of Regulation (EU) 2016/1011 (the 'Benchmarks Regulation', 'BMR').
- As outlined in the Consultation Paper on the review of the RTS on recognition , ESMA took the opportunity of the review to address the shortcomings identified in the meantime based on three full years of NCAs' experience in recognising and supervising third country administrators as well as ESMA's own experience since it started its supervisory mandate in January 2022, specifically related to missing information of an application for recognition.
- Further, the information required from an applicant located in the Union should be consistent with the one required from an applicant located outside the Union applying for recognition under the BMR, in order to avoid a disparity of treatment between third-country and EU benchmark administrators and to ensure a level playing field. Therefore, in this consultation ESMA is aligning the RTS on authorisation and registration with the final report on the RTS on recognition.

- Q1: Do you agree on the proposed addition of Article 3? Do you have any other suggestions?
- Q2: Do you agree with the amendments to the RTS as regards the general information that an applicant should provide to its relevant competent authority?
- Q3: Do you agree with the amendments to the RTS as regards the organisational structure and governance that an applicant should provide to its relevant competent authority?
- Q4: Do you agree with the amendments introduced regarding the self-declaration and the criminal-record file of the members of the management body and the oversight function? Do you think that other information should be requested?
- Q5: Do you agree with the amendments to the RTS as regards the link to the level 1, level 2 and level 3 requirements?
- Q6: Do you agree with the amendments to the RTS as regards the reference to the BMR requirement for completeness?
- Q7: Do you agree with the amendments to the RTS as regards the further specification of the information technology systems and the outsourcing?
- Q8: Do you agree with the amendments to the Annex II of the RTS? Do you have any other suggestions?
- Q9: Do you have any other suggestions of amendments to the RTS?

Bank Funding Risk, Reference Rates and Credit Supply; *Federal Reserve Bank of New York Staff Reports; By Harry Cooperman, Darrell Duffie, Stephan Luck, Zachry Wang and Yilin (David) Yang*

- This paper examines how the choice of loan reference rates affects the supply of revolving credit lines. The transition from LIBOR to SOFR could lead to heavier drawdowns on credit lines during periods of market stress.
- Credit-sensitive reference rates, such as LIBOR, typically rise in a stressed market environment, reducing borrowers' incentives to draw on committed credit lines. Risk-free reference rates typically fall when markets are stressed. This gives an incentive to borrowers to draw more heavily on credit lines when bank funding costs rise.
- The paper suggests this behavior is priced into the terms of SOFR-linked lines, increasing the expected cost of drawn credit and reducing credit line commitment. The impact of the transition on credit supply varies significantly across different types of banks.

Transitioning from WIBOR – implications for Polish debt capital markets; *As WIBOR is a key benchmark for PLN bonds, the Polish National Working Group for benchmark reform was formed to navigate transition from WIBOR to WIRON. Polish issuers and debt capital markets participants will need to carefully consider how this changing environment will impact new and existing capital markets documentation, particularly in respect of instruments maturing after the 2025 deadline for WIBOR cessation.*

- This briefing paper discusses the impact of the transition from WIBOR to WIRON on the Polish debt capital markets and what issuers and their advisers will need to consider.

Cessation of 1- and 6-month synthetic sterling LIBOR; *The benchmark LIBOR is being wound down. Firms must act to transition dependencies to appropriate alternatives.*

- In particular, firms should be prepared for 1- and 6-month synthetic sterling LIBOR to cease permanently at end-March 2023.
- Read more information on initiatives and actions to support the transition away from LIBOR.

Exchanges move to prepare for Libor migration The approaching June 30 deadline for converting US dollar Libor swaps contracts to the Secured Overnight Financing Rate has prompted some clearinghouses and exchanges to schedule dress rehearsals to ensure the execution of the full transition goes smoothly. Financial News

Looking at a specific 3-year SOFR Cap, the premium due to the compounding rate defined as backward looking rather than forward looking – as in legacy Libor Caps - amounts to 7 bp.

- SOFR caps are new, but the underlying issues are old.

- Some pricing formulas for options on compositions (e.g. Backward looking SOFR) were presented in -: Henrard, Marc P. A., Libor Market Model and Gaussian HJM Explicit Approaches to Option on Composition (November 29, 2005). Available at SSRN: https://ssrn.com/abstract=888484.

Effect of Backward vs Forward Looking SOFR on CAP Price	
Price of CAP on **Backward Looking** SOFR:	$2,020,103
Price of CAP on **Forward Looking** SOFR:	$1,948,833
Difference:	$71,269
Difference in bp:	**7.13**

AVERAGE AND TERM SOFR VOLUMES IN 2022; *Recently I looked at* *Term SOFR and BSBY Volumes in 2022* *and in that article I used a pretty loose definition of Term SOFR; basically anything where the index was not the standard overnight SOFR index. My goal being to isolate the trades not using overnight SOFR.*

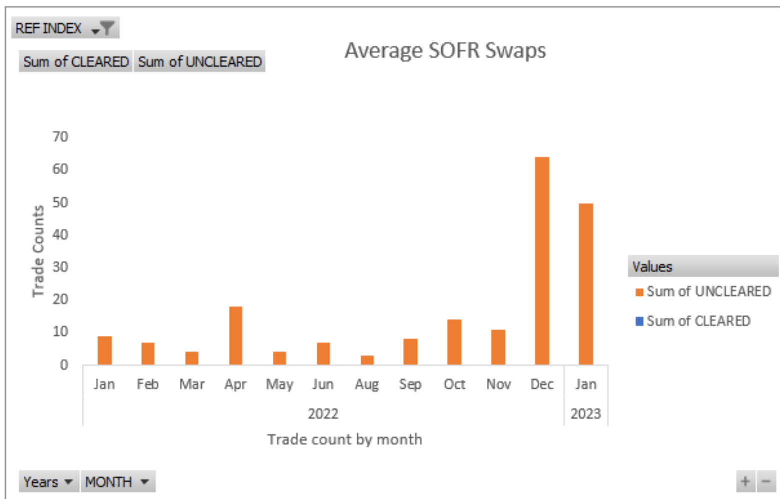
- Today I want to separate out the use of an Average SOFR (backward looking) and Term SOFR (forward looking) from overnight SOFR.
- Definitions
- The Federal Reserve Bank of New York each day publishes overnight SOFR as well as SOFR Averages, which are available here. These are backward looking averages, so at the end of each rolling 30-Day, 90-Day, or 180-Day period, the daily SOFR observations in the period are averaged and an Average SOFR published.
- CME each day publishes Term SOFR rates for 1-month, 3-month, 6-month and 12-month, which are forward looking, so for the period ahead and calculated from CME SOFR Futures, which have been hitting record volumes month on month as volume migrates from CME Eurodollars to SOFR Futures.
- CME Term SOFR Rates are available here and an extract of today's data table shows.

DATE	CME TERM SOFR (%)				SOFR *		SOFR AVERAGES *		
	1 MONTH	3 MONTH	6 MONTH	12 MONTH	OVERNIGHT	INDEX	30-DAY AVG (%)	90-DAY AVG (%)	180-DAY AVG (%)
21 Feb 2023	4.56082	4.82797	5.0657	5.22284	-	1.06655019	4.4674	4.2556	3.6306
17 Feb 2023	4.5635	4.81094	5.03513	5.18677	4.55	1.06601126	4.43435	4.22195	3.57916
16 Feb 2023	4.56327	4.80364	5.02844	5.19136	4.55	1.06587654	4.42632	4.21352	3.56632
15 Feb 2023	4.56391	4.77494	5.008	5.16592	4.55	1.06574185	4.41796	4.2051	3.55349
14 Feb 2023	4.56175	4.76868	4.99157	5.12961	4.55	1.06560716	4.40958	4.1968	3.54065

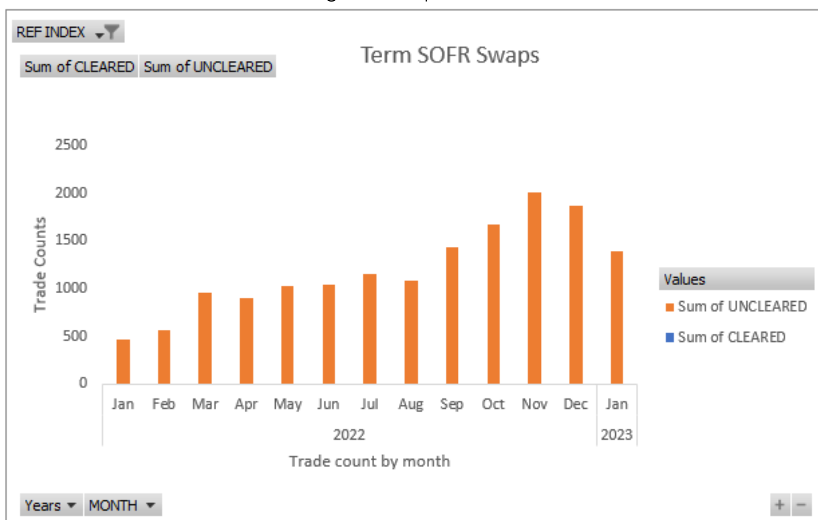
Last Updated: 21 Feb 2023 05:00 CT
In accessing this proprietary data from this website, you acknowledge you have read and agree to all CME Data Terms of Use. To discuss licensing options, please contact CME Data Sales.

- CME Term SOFR Rates Values
- Showing both the most recent 5-days of CME Term SOFR rates, the overnight SOFR and the NY Fed Averages, a super convenient page indeed, including the NY Fed SOFR index, which can be used to easily calculate compounded SOFR for custom periods.
- Swap Volumes for Average SOFR

- In SDRView, I can group USD FixedFloat Swaps by the Reference Index of the floating leg and export this data to create an Excel PivotChart, selecting only those that look like Average SOFR rates (8 different string representations out of more than 30 with SOFR in the name).

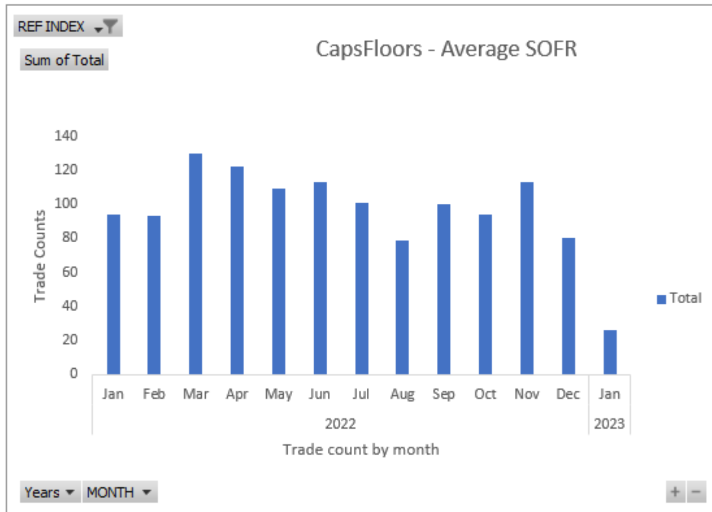


- Showing a small number of trades each month, the peak is 64 in Dec 2022 and 50 in Jan 2023.
- Let's compare that to Term SOFR.
- Swap Volumes for Term SOFR
- This time I selected 24 different strings that had some combination of Term, SOFR and CME along with abbreviations such as TSOFR or CME-TS – bit of a free for all here – surely there is a kosher ISDA Floating Rate Option definition for CME TERM SOFR by now?

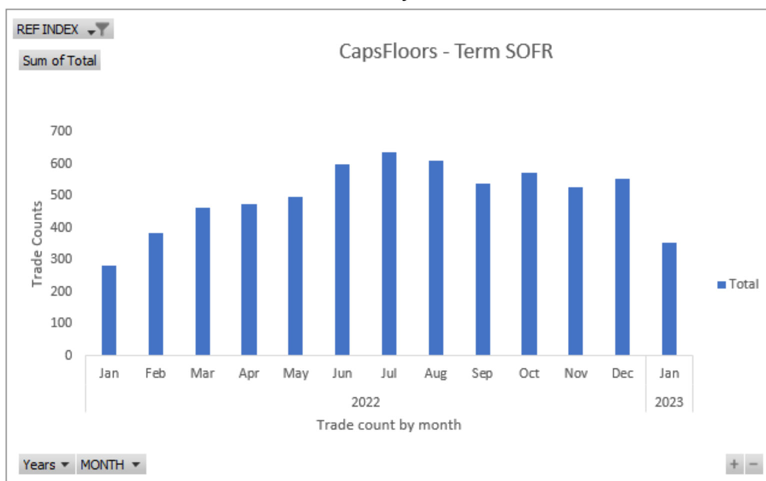


- A much higher number of trades each month, a peak of 2,016 in Nov 2022 and 1,864 in Dec 2022 and 1,386 in Jan 2023.
- So no competition here at all, CME Term SOFR winning hands down over Average SOFR.
- Also just for clarity sake, in Jan 2023, we also see 612 FixedFloat Swaps that reference USD-SOFR-Compound with a reset frequency of 1D, all with platform ID of XXXX, XOFF or BILT, meaning traded off venue, which I would think should be reported as OIS.
- And a quick comparison of the 1,386 Term SOFR Swap trades in Jan 2023, with standard OIS SOFR Swaps of which there are 53,700 trades in the month, shows the relatively niche nature of Term SOFR for Swaps.
- What about CapsFloors?

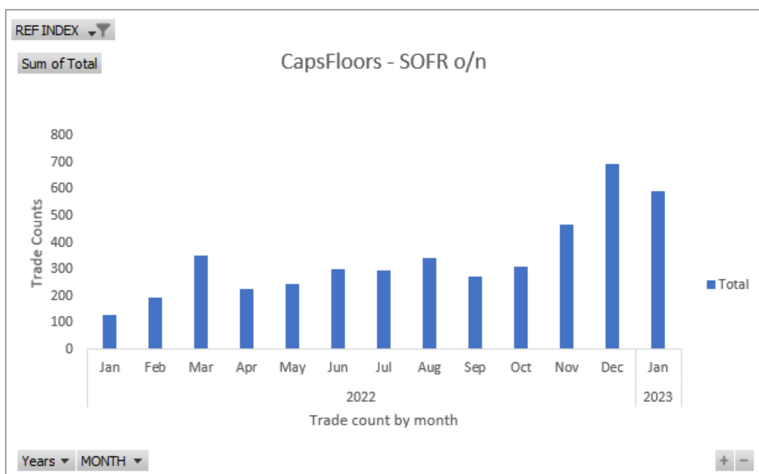
- Starting with Average SOFR, then Term SOFR and then o/n SOFR.



- Most months in 2022 with just over 100 trades and a low of 26 in Jan 2023.



- Most months in 2022 with 500-600 trades and a low of 350 in Jan 2023.



- Most months in 2022 with 200-400 trades, a high of 690 trades in Dec 2022 and Jan 2023 with 590.

- So unlike Swaps, CapsFloors show significant trades in each of O/N SOFR, TERM SOFR and Average SOFR.

An academic paper has argued that fixed income exchange traded funds (ETFs) "improve bond liquidity in general but worsen it in periods of large imbalance between creations and redemptions, such as the COVID-19 crisis."

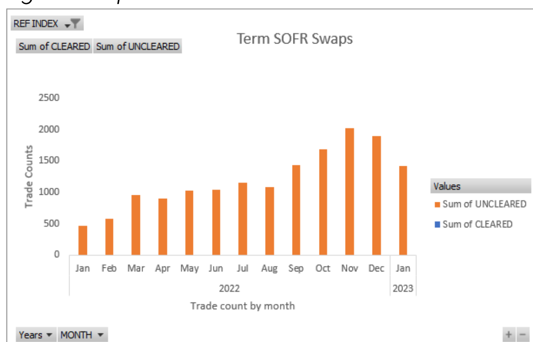
- Written by Naz Koont and Yiming Ma of Columbia Business School, Lubos Pastor from the University of Chicago Booth School of Business and the National Bank of Slovakia, and Yao Zeng from the Wharton School of the University of Pennsylvania, the paper, entitled 'Steering a Ship in Illiquid Waters: Active Management of Passive Funds', looks at the way ETFs use creation and redemption baskets to manage their portfolios. It finds that ETFs are "remarkably active" in their portfolio management, often using baskets that deviate substantially from the underlying index, and adjusting those baskets dynamically.
- By analysing ETF baskets and their dynamics, the paper reports insights into the economics of ETFs and their impact on asset markets. The main insight is that ETFs are active to facilitate liquidity transformation, as ETF shares tend to be more liquid than the underlying securities, in part because authorised participants (APs) conduct arbitrage trades which tend to absorb shocks to investors' demand for ETF shares. "When investors sell ETF shares, APs can buy and redeem them; when investors buy ETF shares, APs can create and sell them. By absorbing the trades of ETF investors, APs reduce the price impact of those trades," it says. "APs' arbitrage trading thus provides liquidity to investors who must trade ETFs at short notice."
- This liquidity provision requires APs to trade basket securities and thus incur transaction costs. To help reduce those costs, ETFs adjust their baskets to make them cheaper to trade. While these basket adjustments facilitate liquidity transformation, they also constrain the ETF's index-tracking capacity." The paper argues that ETFs are active because they care not only about index tracking but also about liquidity transformation, and because only active basket management allows them to balance both objectives. As a result of ETFs' active basket management, there are spillover effects from basket inclusion to the liquidity of the underlying securities. Another key insight for bond ETFs is that their active basket management has significant consequences for bond market liquidity. "In normal times, a bond's inclusion in an ETF basket makes the bond more liquid because shocks to investors' demand for ETF shares are largely idiosyncratic," it says. "A random mix of creations and redemptions across ETFs increases the trading activity in basket bonds, improving their liquidity."
- "That is not the case, however, in periods when investors' liquidity shocks are systematic, resulting in imbalances between creations and redemptions," it continues. "For example, large redemptions move many redemption basket bonds to APs' balance sheets. The APs, who also tend to act as market makers in these bonds, may then become reluctant to purchase more of the same bonds, reducing their liquidity. The effect of basket inclusion on bond liquidity is thus state-dependent: positive in normal times but negative when there is large imbalance between creations and redemptions."
- The full paper can be found here https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4053844

ICE SONIA Futures and Options Reach Record Volume as Investors Return to U.K. Markets; volume in SONIA futures and options as investors return to U.K. interest rate futures markets. A record 1.147 million SONIA futures and options traded on February 2, 2023, including a record 979,561 in SONIA futures, a 19% increase on the previous record. Open Interest in SONIA futures and options is up by a third since the start of 2023 at 2.758 million contracts. /jlne.ws/3JJC7dv

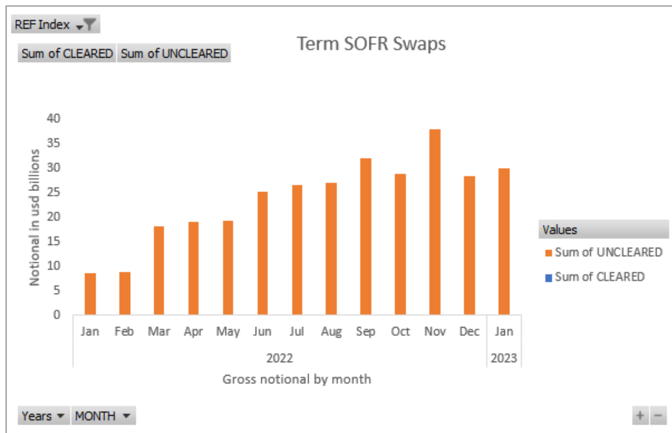
Historic Rise in SOFR Trading Beats Anything in Eurodollars; *January's open interest rise biggest in CME exchange history new options positioning boosted by one massive condor trade Options traders scrambling to gauge the direction of the Federal Reserve made CME Group history last month and new bets are still accruing*.

- Uncertainty over the Fed's policy path drove the largest ever monthly gain for new options positions linked to the US interest rate gauge known as Secured Overnight Financing rate, or SOFR, in January. It was the single biggest surge for any product in its history— including predecessor Eurodollar options — according to the exchange. SOFR options inflows topped 13.4 million contracts, surpassing a previous high of 10.4 million set by Eurodollar options in 2016, CME analysis shows.

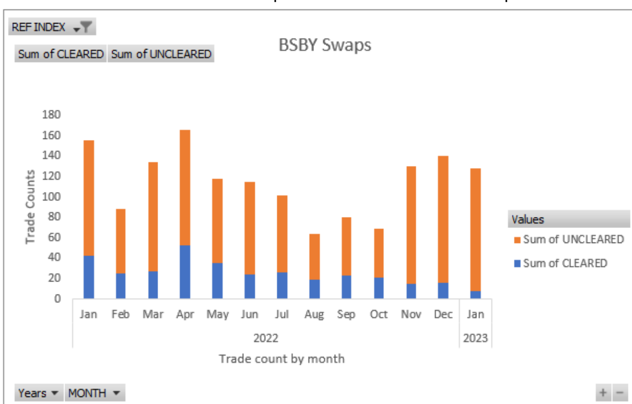
ClarusFT; Term SOFR & BSBY Volumes in 2022; Amir Khwaja;
We looked into Term SOFR and BSBY Swap Volumes in April 2022 and What's New in Term SOFR in November 2022, so today I will update that blog to see how trade volumes in these reference indices developed in 2022.
Term SOFR Swaps; *In SDRView, I can group USD FixedFloat Swaps by the Reference Index of the floating leg and export this data to create an Excel PivotChart, which selects just Term SOFR trades.*



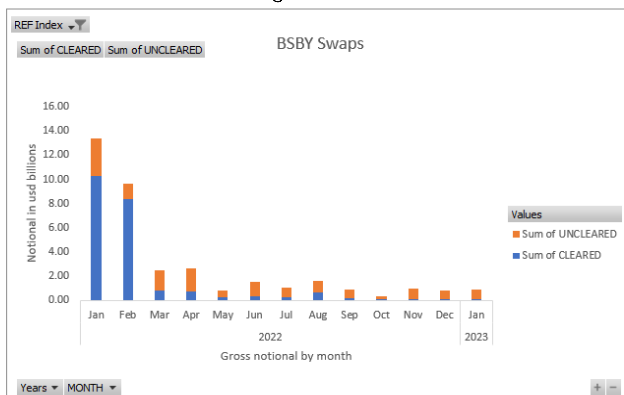
- The number of trades in a month:
    - 471 in Jan 2022
    - 959 in Mar 2022
    - 1,150 in Jul 2022
    - 1,437 in Sep 2022
    - 2,023 in Nov 2022
    - 1,423 in Jan 2023
    - All are Uncleared (and Off SEF).
- So, we continue to see an upward trend in monthly volumes, though with overall trade volumes of 15,000 to 20,000 per month in this product type, this represents <10% of overall volume.
- For instance, in Jan 2023, we see 17,800 trade counts, of which 15,255 are Libor, 2,273 SOFR and 273 Other. Of the 2,273 SOFR, we identify 1,423 as Term SOFR, however the wide range of naming conventions for the SOFR reference index (over 25 variations!) makes this an in-exact science. To get 1,423, we have taken anything which looks like a Term SOFR Rate (e.g., TSOFR or CME TERM SOFR) as well as any SOFR Average but ignored ones that just have SOFR (the remaining 850 out of 2,273).
- Next the same selection but with gross notional.



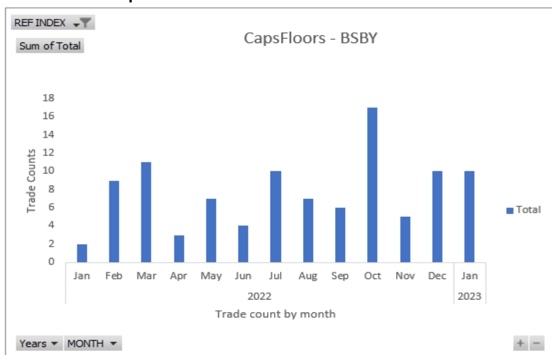
- Again, showing a steadily increasing trend from $9 billion in Jan 2022 to $29 billion in Jan 2023, with a high of $38 billion in Nov 2022.
- The $29 billion in Jan 2023 is only 1% of the $3.5 trillion in USD FixedFloat Swaps reported; much lower than the 8% of trade count in the month.
- In summary, we would say that Term SOFR Swap volume is ticking along with a slow increase but remains small, uncleared and off venue.
- BSBY Swaps; Next lets repeat the above from SDRView for Swaps that reference the Bloomberg Short-term Bank Yield Index (BSBY), available here, which is series of credit sensitive reference rates that incorporate bank credit spreads and a forward term structure.



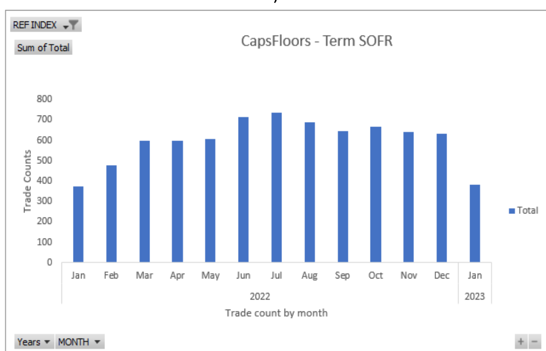
- No clear trend, with 120 uncleared trades and 15 cleared trades in each of the prior 3 months.
- Jan 2023 with just 128 trades in total.
- Let's switch to gross notional.



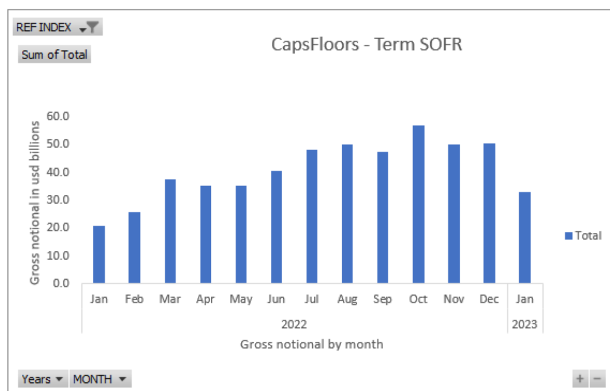
- After the highs in Jan and Feb 2022 of $13 billion and $10 billion, we are down to < $1 billion in each of the prior 5 months, with $800 million in Jan 2023.
- In Summary BSBY use is at very low levels and looks to be tailing off.
    - It is a small fraction of Term SOFR volumes, suggesting that Term SOFR has a significant lead in being the Term rate of choice where firms do not use the standard daily compounded in arrears SOFR rate.
- Basis Swaps
    - A quick look at Basis Swaps that reference either BSBY or Term SOFR, shows tiny volume for either.
    - BSBY with between 1-5 trades a month and then nothing in the last two months.
    - Term SOFR with 20-40 trades a month.
    - No need for charts here.
- Caps Floors



- Around 10 trades a month that reference BSBY.
- So not material, let's move onto Term SOFR.



- Significantly more that reference Term SOFR with 650 trades in most months in 2022.
- Jan 2023 with 384 trades that reference Term SOFR out of a total of 983 that use SOFR or Term SOFR and 97 LiBOR and 150 Other. Meaning Term SOFR represents a significant chunk > 30% of all Caps Floors trades in the month. (But again with > 25 variations of Term SOFR names, albeit many with only a few trades, our numbers above are subjection to some variation).



- Volumes at $50 billion in each of Nov and Dec 2022, while Jan 2023 has $33 billion.
- This compares to total Caps Floor volume in these same months of $235 billion, $305 billion and $300 billion, so Term SOFR share represents between 11% to 21% monthly share.
- Term SOFR certainly seems to have become well adopted for Caps Floors trades.
- A quick look at the SDRView Trade list for CapsFloors shows both SOFR and TSOFR trades, with the latter all Off venue.

Time	Product	Type	Pkg	USD(M)	Rate	Tenor	Platform	Act
Feb 06 22:04:02	CF SOFR			460*	500	2Y	BILT	
Feb 06 21:43:00	CF TSOFR	CALL		70	4.65	18M	XXXX	
Feb 06 21:33:58	CF TSOFR			49	0	Brk	XXXX	
Feb 06 21:26:11	CF TSOFR	CALL		72	700	3Y	BILT	
Feb 06 21:20:00	CF TSOFR	CALL		36	4.65	18M	XXXX	
Feb 06 21:16:28	CF FF	CALL		150	0	Brk	BILT	
Feb 06 21:09:36	CF TSOFR	CALL		70	465	18M	BILT	
Feb 06 21:09:36	CF TSOFR	CALL		36	465	18M	BILT	
Feb 06 21:03:59	CF SOFR	PUT	Pkg	1,000	4.904	3M	BILT	
Feb 06 21:03:59	CF SOFR	CALL	Pkg	1,000	0	3M	BILT	
Feb 06 21:03:12	CF SOFR	PUT	Pkg	1,000	4.904	3M	BILT	
Feb 06 21:03:12	CF SOFR	CALL	Pkg	1,000	0	3M	BILT	
Feb 06 20:18:02	CF TSOFR	CALL		6	600	3Y	BILT	
Feb 06 20:10:30	CF TSOFR			10	0	Brk	XXXX	R

1-40 of 40 Filter...

Summary

- Term SOFR is being actively used for Swaps and Caps Floors.
- Volumes are ticking along and generally up over 2022.
- Caps Floors in particular are between 10-20% of gross notional each month.
- BSBY has very low use, <1% in Swaps and Caps Floors.

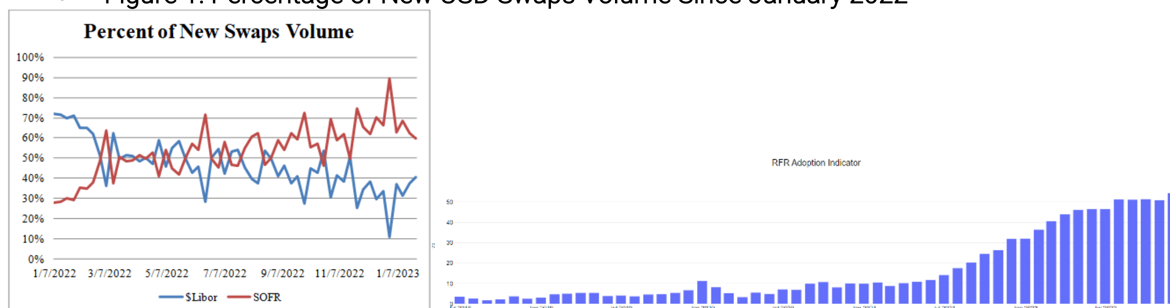
Amidst a long-term trend of rising adoption, January saw a rare decline in the use of risk-free rates (RFR), in terms of percentage of overall interest rate derivative (IRD) volume.

- The ISDA-Clarus RFR Adoption Indicator declined to 51.1% in January 2023 compared to 54.3% in December 2022. The indicator tracks how much global trading activity (as measured by DV01) is conducted in cleared OTC and exchange-traded IRD that reference the identified RFRs in six major currencies.
- On a traded notional basis, the percentage of RFR-linked IRD fell to 48.5% of total IRD transacted in January 2023 compared to 50.1% the prior month. While total IRD trading activity increased in January 2023, trading in legacy rates grew more than trading in RFRs, resulting in a lower percentage of RFR-linked transactions, ISDA says.
- Elsewhere, RFR-linked IRD DV01 increased to $18.1 billion from $14.4 billion in December, while total IRD DV01 grew to $35.5 billion compared to $26.5 billion. RFR-linked IRD traded notional rose to $98.1 trillion from $73.6 trillion and total IRD traded notional increased to $202.5 trillion compared to $147.0 trillion in December 2022.

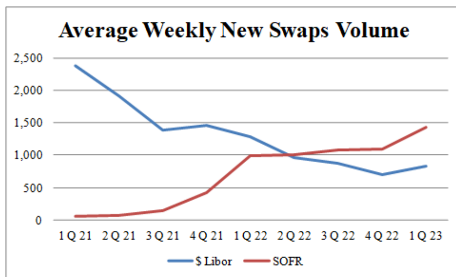
- The percentage of trading activity in SOFR declined to 58.5% of total USD IRD DV01 in January 2023 compared to 64.1% in December, while CHF, GBP and JPY accounted for 100% of total CHF IRD DV01, 99.8% of total GBP IRD DV01 and 98.0% of total JPY IRD DV01, respectively. JPY had the highest percentage of RFR-linked IRD DV01 executed as transactions with tenors longer than two years.

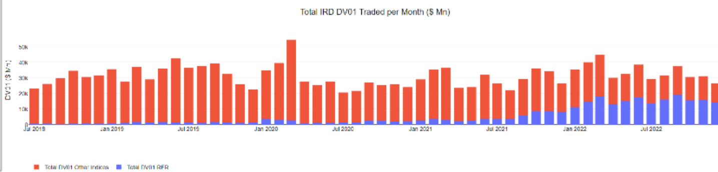
Crunch Time coming up on Libor Replacement With the June 30th supposed end date for $ Libor approaching, the ARRC (the official US body on this topic) has indicated that some Libor tenors may persist after that date; but notwithstanding substantial market pressure, especially from the active Swap Dealers, it has again **stood firm against the use of term SOFR** to hedge interdealer risks / MAtT use on SEFs.

- Unsurprisingly, some benchmark Libor tenors may persist after that date. Clearly the FCA/BOE are in difference to this US process. C$ takes a different route.
- Recently the ARRC issued a couple of documents: a readout from a January 19th meeting and a summary of its recommendations. Those documents give us some insights into the job remaining.
- Between now and the end of June, the financial markets will feel the IBOR replacement pressure building to historic levels, and each market participant will occupy a complex universe of internal and external demands. PDF Could be that Fed Funds contracts become the late day winner…
- Situation; Looking at the swaps data on the migration away from $ Libor and to SOFR. Three recent ClarusFT blogs are attached for context, as well as the ISDA SwapsInfo report which tracks the new swaps volume on a weekly basis, and Figure 1 shows the percentage of new USD swaps volume in those rates since the beginning of 2022. ClarusFT also note the C$ switch-over from CDOR has been occurring only on the D2D trading venues and flags the upcoming deployment of Term CORRA Swaps markets (*On January 11, 2023, the "CARR" announced that both a 1- and 3-month Term CORRA benchmark are under development, with a targeted official publication date of end of Q3-2023*)
- Figure 1: Percentage of New USD Swaps Volume Since January 2022



- We can see from this that the $ Libor market share has been fluctuating above a minimum of 30% since mid-2022, with one week at 10%. This data does not separate the swaps into tenors, which may explain why the ARRC says that "*SOFR swaps have consistently accounted for more than 85 percent of daily average risk traded in the outright linear swaps market since June 2022, while LIBOR swaps accounted for less than 10 percent of the overall volume over the same period*."
- Figure 2 sets out the average weekly volume of new swaps over the same period, and it shows that new SOFR volume plateaued throughout 2022 while $ Libor fell gradually, with a slight uptick for both benchmarks in 2023.
- Figure 2: Average Weekly Swaps Volume by Benchmark



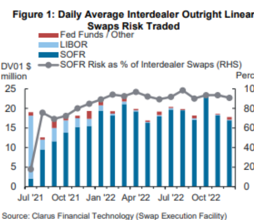


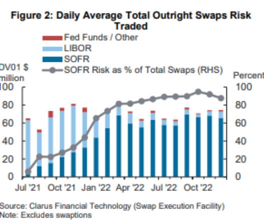
- Of interest is that we had *$3.5 trillion* of new $ Libor swaps created in January of 2023, less than six months before the benchmark is supposed to go away.
- The DV01 take-up is less spectacular, even in the ISDA data, than the headline adoption (*albeit that the muRisQ Advisory Henred approach is, oddly, purely on notionals*)

Highlights from the Alternative Reference Rates Committee (ARRC) meeting on January 19, 2023.
The complete meeting agenda & The complete meeting minutes

- ARRC members noted continued progress in the transition from LIBOR to SOFR. As shown in the charts below, data from cash and derivatives markets show continued momentum in the transition. SOFR is predominant across cash and derivatives markets.
  - Specifically:
  - Figure 2 shows that SOFR swaps have consistently accounted for more than 85 percent of daily average risk traded in the outright linear swaps market since June 2022, while LIBOR swaps accounted for less than 10 percent of the overall volume over the same period.

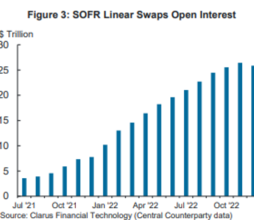
Linear Swaps

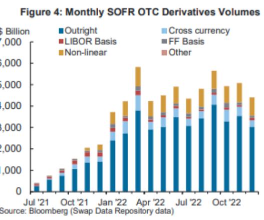


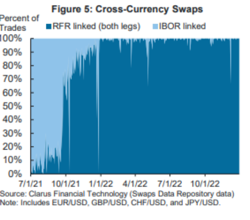


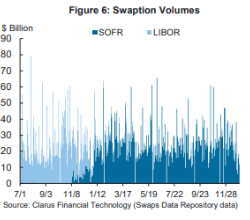
Cross-Currency Swaps

Non-Linear Derivatives





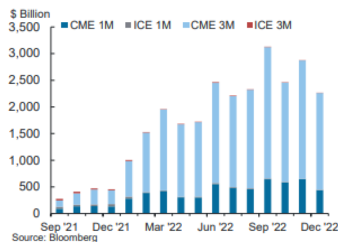




  - Figure 8 shows that average daily SOFR futures volumes steadily increased throughout 2022 and remain well above average daily Eurodollar futures volumes. Conversely, average daily Eurodollar volumes have diminished considerably throughout 2022.

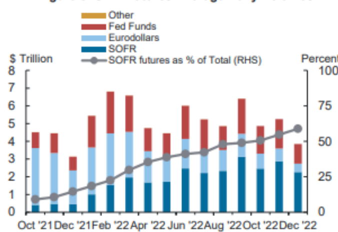
Exchange-Traded Derivatives

Figure 7: Average Daily Notional SOFR Futures Volumes



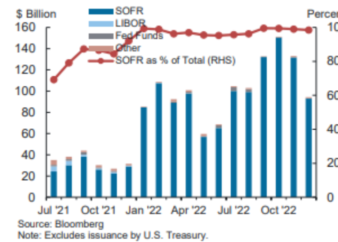
Source: Bloomberg

Figure 8: STIR Futures Average Daily Volumes



Cash Products

Figure 9: FRN Issuance by Reference Rate

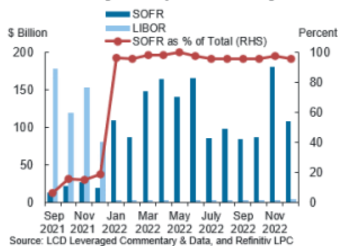


Source: Bloomberg
Note: Excludes issuance by U.S. Treasury.

Figure 10: SOFR FRN Issuance by Issuer Type

Source: Bloomberg
Note: Excludes issuance by U.S. Treasury.

Figure 11: Syndicated Lending



Source: LCD Leveraged Commentary & Data, and Refinitiv LPC

- As noted *in CME Group's January 2023 Rates Recap*, SOFR futures and options experienced tremendous growth during 2022. Average daily volumes and peak open interest for SOFR futures increased by several multiples compared to 2021 while average daily values and peak open interest for SOFR options increased by well-over several thousand multiples year-over-year. This year has also started strongly, with a single-day record of almost 7.6 million SOFR futures and options traded and record open interest of approximately 35.7 million contracts on January 12.
- As the LIBOR transition enters its final months, the ARRC refreshed its sentiment survey to focus on any remaining obstacles and areas of focus. In the most recent sentiment survey of ARRC members, respondents continued to characterize the LIBOR transition overall as progressing smoothly or generally smoothly into 2023. Several respondents noted slower progress in remediation of syndicated loans. The ARRC discussed how the preparation of legacy loan contracts is progressing across the bilateral and syndicated loan markets and how to encourage further transition progress, particularly in syndicated loans.
- The ARRC noted the Federal Reserve Board's publication of its final rule under the LIBOR Act, which is substantially similar to the Board's original proposal. The ARRC voted to adjust its recommendations to conform with the Federal Reserve Board's benchmark selections for FHFA-regulated-entity contracts and Federal Family Education Loan Program (FFELP) asset-backed securitizations.
- The Operations/Infrastructure Working Group provided an update on its work on the DTCC's enhanced LENS system aimed at facilitating effective and efficient communication of rate changes in LIBOR contracts following June 30, 2023. For U.S.-issued securities, the ARRC recommends that all determining persons, agents, and other parties responsible for disseminating information use this system as soon as available for communicating rate/conforming changes:
  - Testing on the front-end data screens began in November and ended this week, with good participation across the market.
  - The next step is to test the downstream process to market data providers with a target to release the overall Enhanced LENS System by end of February / beginning of March.
  - The group also continues to collaborate with DTCC to create a centralized LIBOR transition site to house documents on how the use the new tool, FAQs, and additional LIBOR transition background information.
- The Term Rate Task Force provided an update on its discussions around its existing ARRC best practice recommendations on the scope of use of Term SOFR, which were guided by the

principles set out by the ARRC and are in line with guidance issued by the Financial Stability Board.

- The ARRC discussed the risks associated with any widespread usage of Term SOFR outside of the limited and targeted recommendations suggested by the ARRC as best practice, which have been carefully calibrated to ensure the robustness and sustainability of the rate itself and to avoid risks to financial stability.
- These risks have also been discussed by the official sector both at the December 16, 2022, FSOC Principals meeting and in the FSOC 2022 Annual Report.
- The latter noted that "[w]hile the Council recognizes the usefulness of Term SOFR in certain business lending transactions, it endorses the ARRC's recommendations to limit the use of Term SOFR in other markets and strongly encourages market participants to limit the usage of Term SOFR in derivatives and most other cash markets."

- In addition, the Financial Stability Board published its 2022 Progress Report on LIBOR transition, which encouraged all administrators of Term RFRs to strongly consider matching their licensed scope of use to the recommendations made by the official sector and national working groups. The ARRC discussed the strong and consistent messaging across the official sector and reiterated its existing best practice recommendations. The ARRC plans to continue to assess the use of Term SOFR in relation to its recommended scope of use and guiding principles.
- The ARRC also reviewed and finalized a document titled Summary of Key ARRC Recommendations, which summarizes the ARRC's key recommendations for the LIBOR transition and provides associated resources as the LIBOR transition enters its final stages. *The document highlights the 3 main messages below:*
  - Take action now to remediate legacy contracts ahead of June 30, 2023.
  - Communicate planned rate changes and use the DTCC's enhanced LENS system as soon as available to effectively disseminate information on rate changes for securities.
  - Use the Secured Overnight Financing Rate (SOFR) as the replacement rate for USD LIBOR and as the basis of the transition in cash and derivatives markets.
  - The ARRC and official sector recommend that use of Term SOFR remain limited to support financial stability.

Alternative Reference Rates Committee: Key Messages; *As we quickly approach the end of the USD LIBOR panel after June 30, 2023, the ARRC would like to remind market participants of key recommendations to facilitate a smooth transition at this stage of the transition:*

1. **Take action now** to remediate legacy contracts ahead of June 30, 2023.
2. **Communicate** planned rate changes and use the DTCC's enhanced LENS system as soon as available to effectively disseminate information on rate changes for securities.
3. Use the **Secured Overnight Financing Rate (SOFR)** as the replacement rate for USD LIBOR and as the basis of the transition in cash and derivatives markets. • The ARRC and official sector recommend that use of Term SOFR remain limited to support financial stability.

Act Now on Legacy Contracts: Market Participants should act now to remediate legacy contracts.
Official Sector Remarks Have Highlighted the Importance of Acting Now to Remediate Contracts:

- The official sector has encouraged remediation ahead of June 2023 to avoid a pile up risk on numerous occasions. See remarks from the Federal Reserve Board, Federal Reserve Bank of New York, CFTC.
- At the FSOC Principals meeting on December 16, 2022, Vice Chair Barr made it clear that:
  - *"The sheer size of remaining legacy dollar LIBOR contracts means that waiting until June 30 next year [to transition legacy contracts] comes with significant operational risk. Supervisors have long emphasized the expectation that market participants progress towards an orderly transition away from LIBOR.*
  - *Supervisory expectations for LIBOR transition remain unchanged. Neither the slowdown in refinancing activity, nor the plans of the U.K. FCA to require temporary publication of synthetic USD LIBOR rates alters supervisory guidance.*

  - *Firms should be working now with their customers to move contracts away from LIBOR well ahead of June [2023]."*
- In addition, the FSOC 2022 Annual Report includes the following recommendation:
  - *"The Council advises firms to take advantage of any existing contractual terms or opportunities for renegotiation to transition their remaining legacy LIBOR contracts before June 30, 2023."*
- The ARRC recommends that parties remediate their contracts to move from LIBOR to SOFR now to reduce unnecessary uncertainty, avoid unintended adverse outcomes, and to mitigate associated operational risk:
  - Remediating contracts by moving off LIBOR can allow counterparties to set the terms of the LIBOR transition that best suit them, rather than needing to rely on fallback language or the LIBOR Act to set those terms.
  - Even in cases where the contract is deemed to have a workable fallback, counterparties still need to assess whether they are in a position to operationally handle the potentially large number of contracts that may be changing after June 30, 2023. Remediating contracts by moving them out of LIBOR before this date will help to lessen those operational challenges.
- Key Resources:
  - The ARRC's Legacy Playbook contains a range of information and materials helpful in contract assessment and recommendations for contact remediation.
  - Also see the Federal LIBOR Act (starts on page 777) and the FRB's Final Rule, as well as the UK Financial Conduct Authority's consultation on synthetic USD LIBOR.
  - In addition to LIBOR contracts, market participants should remediate contracts referencing the USD LIBOR ICE Swap Rates.

Communicate Changes: Market Participants should ensure the timely communication of LIBOR-transition related changes to contracts.

- The ARRC has consistently emphasized that responsible parties should communicate their planned rate changes ahead of June 30, 2023.
  - For U.S.-issued securities, the ARRC recommends that all determining persons, agents, and other parties responsible for disseminating information use the DTCC's enhanced LENS system once it is available for communicating rate/conforming changes.
  - See the ARRC's Legacy Playbook, DTCC info hub and Refinitiv's fallback page
- Official Sector Remarks Have Highlighted the Importance of Communicating Changes and Use of the DTCC's Enhanced LENS System:
  - *"The Council advises responsible parties to communicate any outstanding decisions regarding the rates to which outstanding legacy LIBOR contracts will transition and any necessary conforming changes well in advance of June 2023….*
  - *The Council also encourages securities issuers and trustees to use the enhanced LENS system to ensure they have effectively communicated rates and conforming changes where applicable."*

Use SOFR: The ARRC recommends SOFR as the basis for the transition in cash and derivatives markets.

1. The ARRC's selection of SOFR followed extensive input from a wide range of market participants and reflects the depth of SOFR's underlying market and its likely robustness over time; *the rate's usefulness to market participants; and SOFR's construction, governance, and accountability being compliant with the IOSCO Principles for Financial Benchmarks.*

- The ARRC's Second Report contains more information about the ARRC's objectives and work undertaken to deliver these objectives.
- The ARRC has produced a user's guide to SOFR, which includes information on the ways in which cash market participants can calculate SOFR averages and factors to consider when determining which SOFR average to use.
- The ARRC has also published a guide to SOFR averages, which outlines how the Federal Reserve Bank of New York calculates various SOFR averages and details where they are published.

- The ARRC has also published information on conventions for SOFR.
  - floating rate notes,
  - syndicated business loans,
  - bilateral business loans,
  - intercompany loans,
  - consumer mortgages, and
  - student loans

2. Use SOFR: The ARRC recommends a limited scope of use for Term SOFR.

- *In order to support a robust, sustainable transition and help ensure financial stability, the ARRC recommends a limited scope of use for Term SOFR*.
- The ARRC only recommends use of Term SOFR in certain circumstances, as set out in the ARRC's best practice recommendations on the scope of use of Term SOFR. For new contracts, the ARRC recommends:
  - The use of Term SOFR, in addition to other forms of SOFR, for business loan activity
    - particularly multi-lender facilities, middle market loans, and trade finance loans
    - where transitioning from LIBOR to an overnight rate has been difficult and where use of term SOFR could help address such difficulties.
  - The use of Term SOFR for certain securitizations that hold underlying business loans or other assets that reference Term SOFR and where those assets cannot easily reference other forms of SOFR.
  - Any use of SOFR Term Rate derivatives be limited to end-user facing derivatives intended to hedge cash products that reference the Term SOFR.
- This limited scope of use is critical to ensure that the vulnerabilities that prompted the LIBOR transition are not reintroduced; for example, having use of Term SOFR that becomes disproportionate relative to the volume of transactions underlying Term SOFR

3. Use SOFR: The official sector recommends a limited scope of use for Term SOFR

- Official Sector Remarks Have Highlighted the Importance that Any Use of Term SOFR be Limited and be Consistent with the ARRC's Recommended Scope of Use:
- On December 16, 2022, at the FSOC Principals meeting, Vice Chair Barr made it clear that:
  - *"Overnight SOFR needs to remain the primary tool for derivatives and capital markets. This approach is crucial to the success of LIBOR transition. A world in which Term SOFR is used across all or most cash products is not a plausible one. Such a world would not be consistent with sustaining a robust market for overnight SOFR derivatives, the foundation for Term SOFR rates. Therefore, the use of Term SOFR must remain limited in line with the recommendations of the FSOC and Financial Stability Board."*
- The FSOC 2022 Annual Report also included the following recommendation:
  - *"While the Council recognizes the usefulness of Term SOFR in certain business lending transactions, it endorses the ARRC's recommendations to limit the use of Term SOFR in other markets and strongly encourages market participants to limit the usage of Term SOFR in derivatives and most other cash markets*."
- In addition, the FSB has encouraged all administrators of Term SOFR to strongly consider matching their licensed scope of use to the recommendations of the ARRC.

Ex-Citi Analyst Who Exposed Libor Takes Aim at Its Successor; Scott Peng says limits on term SOFR use are skewing market; Issue likely to worsen unless changes are made, Peng warns. *Over a decade ago, Scott Peng was one of the earliest voices to call out the scandal-ridden London interbank offered rate. Now, he's sounding the alarm over its successor.*

- Peng says guidelines designed to limit who can use derivatives tied to the Secured Overnight Financing Rate are inadvertently heaping risk onto banks' balance sheets, echoing warnings from TD Securities and JPMorgan Chase & Co. Left unchecked, he says, it could pose a significant risk to the smooth functioning of financial markets. "Banks and issuers are just starting to come to grips with this —we are at beginning of a reckoning," said Peng, chief investment officer of

Advocate Capital Management. In 2008, as the former head of Citigroup Inc.'s US rates strategy team, he was among the first to suggest that Libor was understating borrowing costs, helping spark investigations that revealed rampant manipulation and ultimately contributed to the benchmark's demise. "At the present time it's an annoyance, but as that risk position become bigger and bigger at some point it becomes a systemic issue. "

- At the heart of the matter is the decision by the Alternative Reference Rates Committee —the Federal Reserve-backed body overseeing the transition from dollar Libor —to effectively restrict who can use forward-looking term SOFR swap contracts, which let two parties exchange fixed and floating-rate cash flows over a set period. For the most part, only firms that issue floating-rate debt tied to term SOFR itself, like leverage loans or collateralized loan obligations, can use the derivatives. That's partly because officials don't want markets to overly rely on term benchmarks that lack significant underlying liquidity.
- Many companies that borrow in the $1.4 trillion leveraged loan market offset their interest-rate risk (SOFR moves practically in lockstep with Fed funds) by entering into swaps contracts with banks, paying a fixed rate and receiving a term SOFR rate. The trouble arises when banks then try to hedge their end of the trade. Corporate borrowers on the other side of the coin —those looking to switch from fixed-to floating-rate funding —were once reliable counterparties, but they can't enter into paid term SOFR swaps, given the ARRC's recommendations.
- Instead, banks can only offer swaps derived from overnight SOFR, creating what's known as 'basis risk' on their balance sheets, the result of the mismatched hedges. Peng says that large Wall Street dealers already stand to lose between $5 million and $10 million if the spread between overnight and term SOFR moves against them by just one basis point, and their exposure is growing with every new transaction. "If the risk gets big enough, I can certainly see banks stopping traders from doing more of this," Peng said.
- A representative for the ARRC declined to comment, referring Bloomberg to a readout of the group's most recent meeting, in which it reiterated its existing best practice recommendations while noting that the committee plans to continue to assess the use of term SOFR going forward. CME Group Inc., operator of the exchange in which the bulk of SOFR swaps are cleared and whose licensing requirements for derivatives are aligned with the ARRC's best practices, declined to comment.
- Three-month term SOFR rose to 4.6855% from 4.6817% in the prior session, CME Group data show. 'Risk Issue'; Peng's warnings echo those of JPMorgan's Alice Wang and TD strategist Priya Misra, who in recent months have flagged the accumulation of basis risk by banks as well as the rising cost to borrowers as dealers charge them more to fix their floating-rate obligations using forward-looking SOFR swaps. As a result, investors will have to decide about the trade-off between paying the basis or leaving the risk unhedged, Misra said.
- The ARRC, for its part, has been clear about why it recommends most firms avoid term SOFR derivatives, noting that it wants to prevent "use that is not in proportion to, or materially detracts from, the depth of transactions in the underlying derivatives markets that are essential to the construction of the SOFR term rate over time."
- Regulators are also eager to avoid any real or perceived impropriety linked to SOFR, given Libor's failings. The widespread use of term risk-free rates in derivatives could create conflicts of interest among market participants trading actively in both overnight and term contracts, according to a 2021 report from the Financial Stability Board. Yet Peng warns that without changes to liberalize the usage and clearing of term SOFR swaps, the problem is likely to worsen. "It's a risk issue," Peng said. "Banks are accruing this basis risk on their books. If this continues the spread will widen and widen further. Their existing basis position is going to lose money."
- The Fallback Backlog: All of that swap creation just exacerbates the big issue that the ARRC is focused on, the fallback provisions – or lack thereof – in existing instruments, "*because there are so many interconnected issues, an unstructured approach [to replacement] is bound to fail*." In particular, 5 main issues can be identified:

1. The range of counterparties. With the exception of deriving curves and ladders, virtually every instance of an IBOR involves a transaction with at least two counterparties, and possibly many more. In some cases, parties that might be on opposite sides of one transaction may be on the same side of another, so one negotiation approach can be impacted by other relationships.
2. The range of instruments. Not only are there millions of individual instruments that have to be identified, categorized, and examined, but also different classes of instrument pose different classes of problems.
3. The range of legal language. Two instruments of the same type, even between the same counterparties, often have different contract language based on geography.
4. The range of regulators. Even within countries, different counterparties or instruments can have different regulators, and the situation is more complex when you cross borders. In the US, for example, a borrower using a swap and an FRN to create a fixed rate borrowing and using hedge accounting has two regulators to reckon with, as well as an accounting rule setter.
5. The range of replacement rates. The whole process is further complicated by the fact that some of the IBORs have more than one possible replacement, and various add-ons have been developed and promoted. Thus, the transition can incorporate some difficult decisions and negotiations.
    - In its meeting readout, the ARRC states that market participants must "*Take action now to remediate legacy contracts ahead of June 30, 2023*," but it is worth understanding that different types of instruments, and even different sides of the same instrument, require different types of actions. For example, in some cases, you might have a small number of very large instruments that stretch out for years, some with many counterparties and some with a few. In other cases, you might have a very large number of small instruments, each with a different counterparty, but all the instruments and counterparties tend to act the same.
    - Some instrument types are relatively easy to modify, and others are devilishly hard. Some of these instrument types can only be understood by parsing legal language. What's important is that the instrument types have to be converted into characteristics that can be represented binaurally and used later in classification and enumeration.

- The Fallback Strategy: This categorization and quantification is essential in developing and applying a remediation strategy across the range of existing instruments out there. For large financial institutions, doing this manually was never a good idea, and it is impossible if you are starting at this late date. It may sound simplistic, or even unnecessary, but we have to begin with a set of objectives for each segment since these will impact everything that follows. And these strategies are based on the answers to two questions:
    - Are there customer and instrument segments you want to grow, or others that you are marginally interested in? This is particularly important if the transition process appears to be difficult or contentious. While this can be a negative if the segment is marginal, it can be a real positive if the segment is important because both competitors and customers are going to find the transition difficult to deal with. In that instance an extra effort on your part can actually result in significant market growth.
    - Do you have large-scale competitors in one segment who are customers in other segments? This is one of the most important cross-segment factors to consider. It is not automatic that you let the customer relationship override the competitive one if the competitive relationship is in a more strategic market segment. It certainly is possible to handle both relationships without allowing them to impinge each other, but that often requires careful interaction and an ability to predict a counterparty's reaction to a move on your part.
- Then the strategy is dependent on three questions:
    - What is the best possible outcome for you in this segment? This might sound like a simple question, but it contains a whole set of sub-questions.

- What would it take to achieve that best possible outcome? Would you have to make significant concessions from the positions you currently have in Libor transactions?
- What are the likely reactions of counterparties and competitors to this strategy? In certain cases, such as a customer-friendly education program for retail lending products, the counterparty reactions should be quite predictable, but even in those cases the competitors' reactions might not be.

- Getting to the Finish Line; the big question is getting your counterparties to the finish line. That necessitates some structured steps:
  - Each strategy should be laid out in a series of steps. Whether the essence of the strategy is convincing counterparties to follow your lead, educating naïve customers on the impacts and options of IBOR replacement, or maximizing the profitability of changes you see as inevitable, every strategy must follow a step-by-step implementation. Progressing from step to step can be a matter of obtaining an agreement, the passage of time, or actions by working groups or regulators, but the triggers must be built into the strategy, so they can be monitored and reacted to.
  - The strategy's dependence on external events must be documented and tracked. Since virtually every instance of an IBOR involves more than one party, virtually every IBOR replacement strategy requires interaction with someone else. For large individual transactions, obtaining and recording agreement from the counterparty is the essence of the strategy. In other cases, modifying your position in response to the counterparty's position can be a signal to modify other positions in order to gain a marketing advantage.
  - How well a strategy plays out in the market can be a function of how it is presented. Strategies involving instruments with one party on one side and many on the other, like FRNs, are especially dependent on how the options are presented. If the strategy's success depends on a minimum level of acceptance, building a groundswell of that acceptance may be essential. On the other hand, presenting several options, one of which is obviously advantageous to the counterparties, can portray you a customer-centric, even if the options are less so.
  - In some strategies, timing is everything. There are cases where being the first in front of counterparties with an offering presents you as ahead of the pack, while there are other times were waiting for a competitor to present can make your offering look better by comparison. Allowing a WG decision to be published, where the result may be unpalatable to customers, can be smart timing, while getting in front of a competitor's customers before they do can prompt them to switch to you. Every strategy has its own timing component.
- Finally, every market participant must be ready to make adjustments as the strategies roll out. In particular:
  - The key to successful adjusting is careful planning. And the first component of careful planning is anticipating when adjustments might be required. If you used advanced game theory to anticipate the reactions of customers, competitors, and regulators, you can be ready to move when the change looks best for you, as opposed to looking like you were forced into it.
  - It goes without saying that making adjustments can be a marketing opportunity. Far from grudgingly having to back away from a strategy, adjusting the strategy can be presented as a win-win proposition. This is very hard to do if you wait to make the adjustment until it is obvious that you were forced into it, but the exact same sequence of events can be timed to serve as the resolution of an impasse. Sometimes that can be accomplished by…
  - Incorporating customers and regulators into the adjustment decision. When it becomes obvious to you that an adjustment is necessary, and perhaps exactly what that adjustment needs to be, the whole process can be smoothed, and even recalibrated, by incorporating the right parties into the decision. If one party, such as a customer, may

be resistant to the change, enlisting other parties, like regulators or even competitors, in the event can bring the change about without portraying you as forcing the issue.
  - Between now and the end of June, the financial markets will feel the IBOR replacement pressure building to historic levels, and each market participant will occupy a complex universe of internal and external demands. Balancing those demands, and making lemonade out of lemons, will separate the winners from the also-rans in this sprint to the finish.

NY Fed paper warns of systemic risks from SOFR credit lines; *Stress tests need to account for credit facilities being "drawn to the limit", says Stanford's Duffy*

- Regulatory stress tests may need to be updated to account for the acute drawdown risks faced by banks that offer committed credit facilities linked to the secured overnight financing rate, or SOFR, according to a recent staff paper from the Federal Reserve Bank of New York. The new study, led by Stanford University's Darrell Duffy and researchers at the New York Fed, concludes that most SOFR credit lines would be "drawn to the limit" in periods of market or economic stress, when the risk-free benchmark would track cuts in policy rates even if bank funding costs rise sharply. "There's going to be a big shift in terms of line drawing under stressed markets versus line drawing in normal markets," Duffie tells Risk.net. "I think it's a pretty important point that's not only about day-to-day credit provision but also about systemic stress."
- Committed credit lines account for the bulk of corporate borrowing in the US, according to the staff paper. At the end of 2019, the top 20 US banks had extended more than $1.8 trillion of lines, of which over $1.3 trillion were undrawn.
- The vast majority were tied to Libor, which typically spikes during stress scenarios, discouraging the use of these facilities other than in emergencies. The use of credit lines during recent stress events was relatively modest, the study shows. An additional $300 billion of corporate lines was drawn by April 2020 in response to Covid-19 lockdowns, when the spread between Libor and overnight index swap rates (OIS) jumped to around 140 basis points. These drawdowns were largely precautionary, with most funds left in corporate deposit accounts, which eased funding strains on banks. After the collapse of Lehman Brothers in 2008, when the Libor-OIS spread hit 360bp, an additional $50 billion of lines were drawn, though in this case the funds largely left the banking sector.
- Duffie warns SOFR credit lines could see significantly bigger drawdowns in a future crisis. "We haven't experienced a market that's using SOFR in a crisis," he says. "The last crisis was Covid and that was a Libor-based market. The next time there is a crisis, if corporate borrowers have the option to draw at SOFR rather than Libor, they're going to say: 'Wow, it's a crisis, the Fed has lowered overnight risk-free rates and SOFR is a great deal for us to borrow now.'" Duffie argues this dynamic may need to be incorporated into the Fed's stress tests to properly gauge whether banks can meet funding demands in extreme conditions. "Maybe we should allow for the fact that in a SOFR world, there's going to be a lot more expansion of bank balance sheets in a crisis because corporate borrowers are going to draw much more heavily on their loans. You could mitigate it by simply saying banks have to take a stress test that takes account of heavy drawing and SOFR reliance," he says. This could further increase the cost of SOFR-linked credit lines, which the study estimates are already around 25bp more expensive than Libor versions in normal conditions. Small and regional lenders, which the study finds are less likely to see funds drawn from credit lines redeposited with them in times of crisis, would perform worse in stress tests that factor in their exposure to SOFR credit lines and may need to widen their spreads to compensate, leaving them at a competitive disadvantage to larger rivals.
- A sensitive matter; The Fed staff paper revives a fierce debate around the need for credit-sensitive alternatives to SOFR. A group of regional banks made the case for them in 2019. Regulators refused to entertain the idea, arguing that credit-sensitive alternatives to SOFR, such as Bloomberg's short-term bank yield index, or BSBY, have 'many of the same flaws as Libor'.

While the latest study is independent and does not necessarily represent the views of the Fed, the authors were granted access to confidential and granular bank data to conduct the analysis, which some proponents of credit-sensitive rates see as a sign that the central bank is not deaf to their arguments. 60% The proportion of US swap risk linked to SOFR by December last year.

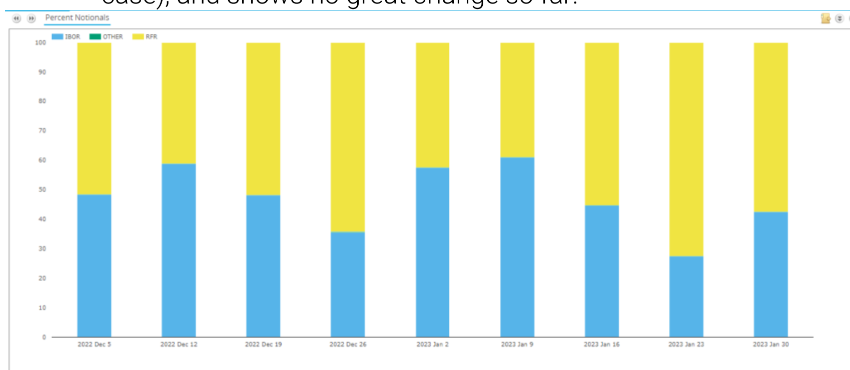
- The earlier debate around credit-sensitive benchmarks took place when regulators were focused on getting SOFR off the ground. That objective has largely been achieved – by December, more than $2.3 trillion of lending agreements and 60% of US swap risk was tied to SOFR. Some regional banks still see a role for credit-sensitive rates in the post Libor world. "You can't really borrow at SOFR as a regional bank and most banks don't find themselves in the repo markets. Only the top 20 really use it," says Reed Whitman, treasurer of Brookline Bancorp in Boston, Massachusetts, which uses SOFR, and a one-month forward version of the credit-sensitive Ameribor benchmark for commercial lending. "From a regional bank perspective, we want our rates to reflect our true cost of funding and reflect credit risk, which means unsecured borrowing, not 'risk free'. Where it's going to manifest itself is in spread differential when new loan products are quoted. If you end up indexing to SOFR, you're going to end up getting a wider spread to account for the lack of credit sensitivity inherent in the index."
- The study shows that small and regional banks face more acute drawdown risks on SOFR facilities. Through the Covid crisis, around 90 cents of every dollar drawn from credit lines was placed back on deposit with banks – offsetting most of the funding risk. For smaller and regional lenders, however, this fell to just 40 cents on the dollar, meaning those banks had to rely on more expensive funding to cover the drawdowns. As a result, the study found smaller banks were more credit sensitive than the largest lenders, equating to roughly 25% of Libor levels. Regional banks could theoretically increase their pricing to account for the higher sensitivity, though Whitman says this is hard to do in practice. "In reality, there are very few institutions that have a treasury department pricing loans. They may have a pricing model, but the lender doesn't necessarily have the cost of funds in the back of the mind when bidding on a competitive deal. It's more a question of what you need to do to win the deal and where the market is. In theory if you have a super-low cost of funds, you can underbid, but that's always been the case," says Whitman.
- An Axi to grind? Stanford's Duffie previously led the creation of the Across-the-Curve Credit Index, or Axi, a credit-sensitive benchmark that is intended to be used as a dynamic spread layered over SOFR. And he is still of the view that such rates have a place in the post-Libor world. "We do think there's a role for credit-sensitive rates," he says. "That's not arguing for a return to Libor. Libor is dead because there are not enough transactions to fix it, so there would have to be some other credit-sensitive rate." Duffie stresses that he has no financial interest in Axi, which is being commercialised by SOFR Academy and Invesco Indexing. That project is gaining traction, with at least one large bank currently in the process of licensing the benchmark for use in commercial loans, according to SOFR Academy chief executive Marcus Burnett.
- Burnett sees the latest Fed paper as a boost for credit-sensitive rates: "We welcome the publication of the paper which shows that a credit-sensitive element can mitigate the unintended adverse impact of Libor transition on the credit channel, and we think the right way to go about that is to have SOFR at the core." Others still see a number of obstacles to the wider adoption of credit-sensitive rates such as Axi and BSBY. "During the outbreak of the pandemic in March 2020, we experienced a scenario where Libor spiked and SOFR went in the opposite direction, so it's definitely a consideration that gave many lenders pause, but it was somewhat short-lived and came with the very forceful message from regulators to embrace SOFR," says Chris Slusher, head of rates at Derivative Path, which is assisting US regional banks with benchmark transition. "It's still a concern for lenders, but you have to weigh those concerns against the operational considerations of whether they can hedge that rate, support it in their loan systems, bill their customers based on that rate, and whether there is liquidity in the market." He says operational efficiency is one of the reasons why "SOFR ended up winning out".
- Convincing corporates to accept a credit spread such as Axi on top of the risk-free rate may prove tricky in current market conditions. CME's one-month term SOFR was 4.57% on February

1, while one-month Axi stood at around 5bp, for an all-in rate of 4.63%. Credit-sensitive alternatives were quoted lower, with one-month BSBY at 4.55% and Ameribor 30T at 4.52%.

Early Libor critic raises concerns over SOFR limits Ex-Citi analyst Scott Peng sounded the alarm about the shortcomings of Libor in 2008, and now is warning that the limits on the use of derivatives linked to the Secured Overnight Financing Rate could create a basis risk for banks. "Banks and issuers are just starting to come to grips with this -- we are at the beginning of a reckoning," says Peng, who is currently Advocate Capital Management's chief investment officer. BNN Bloomberg

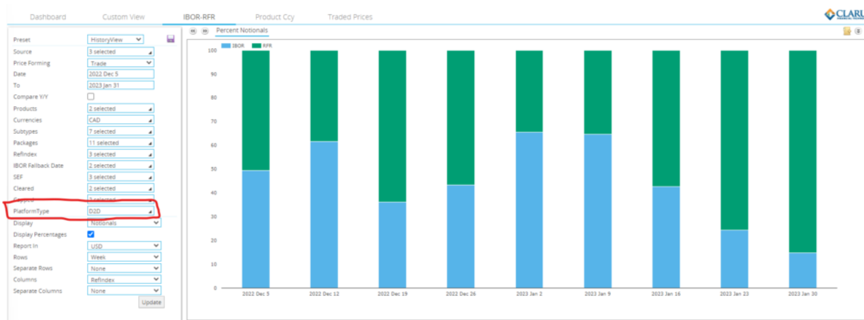
CORRA First – Clients Don't Get It; Chris Barnes; February 1, 2023; *CORRA First was put in place on January 9th 2023 to help CAD interest rate derivatives transition from CDOR to CORRA. For all of the juicy details, please see my blog from last year:*

- Transparency is Better Than Ever
- RFR transition in Canadian markets may seem a little niche for some of our readers. However, it also serves as a fantastic opportunity to highlight the improvements in transparency that the US have introduced since December last year.
- SDR data shows the proportion of trades transacted as RFR or IBOR (CORRA or CDOR in this case), and shows no great change so far:

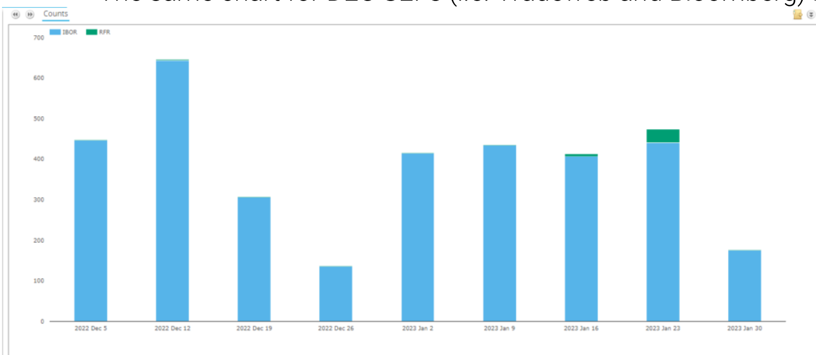


Showing;

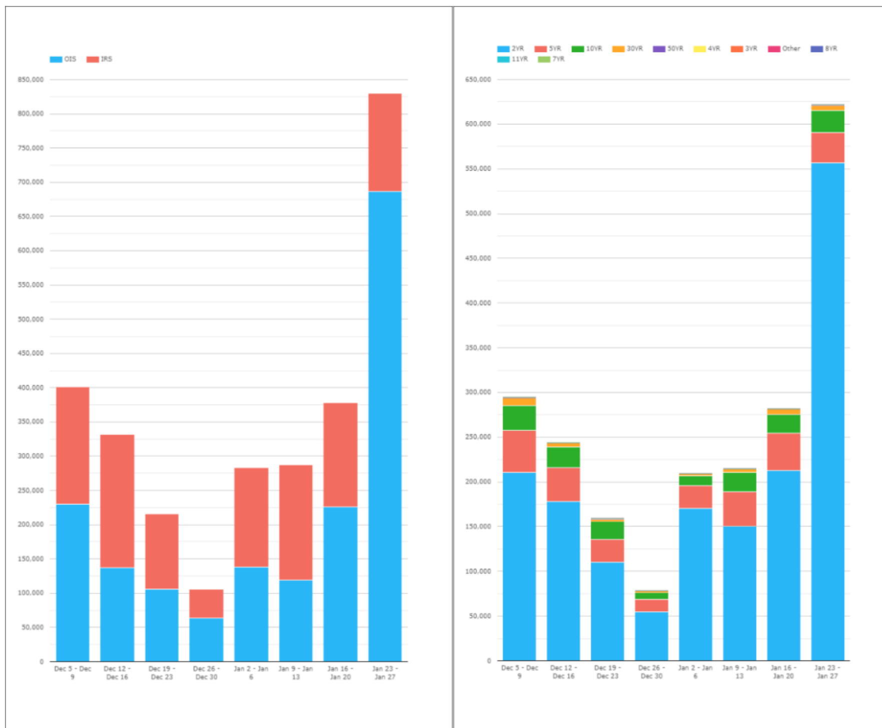
- The percentage of notional for CAD swaps (both vanilla IRS and OIS) that is transacted versus RFR (CORRA) or IBOR (CDOR) each week since the beginning of December 2022.
- It is a volatile measure, ranging from 39% (week of Jan 9th) to 72% (week of Jan 23rd).
- So far this week, we are back to a 57/42% split.
- Even back in December, CORRA accounted for up to 61% of trading.
- Presented as such, it suggests that CORRA First has not really impacted trading activity yet.
- However, that is not true.
- D2D CAD Markets
- Since December, SDR data has included a platform identifier for each trade. This means that we now know, at a transaction level, whether the trade was executed on a Dealer to Dealer or Dealer to Client platform.
- In SDRView we have now added this filter. For CAD markets, the behaviour on D2D platforms has certainly changed as a result of the CORRA First initiative:



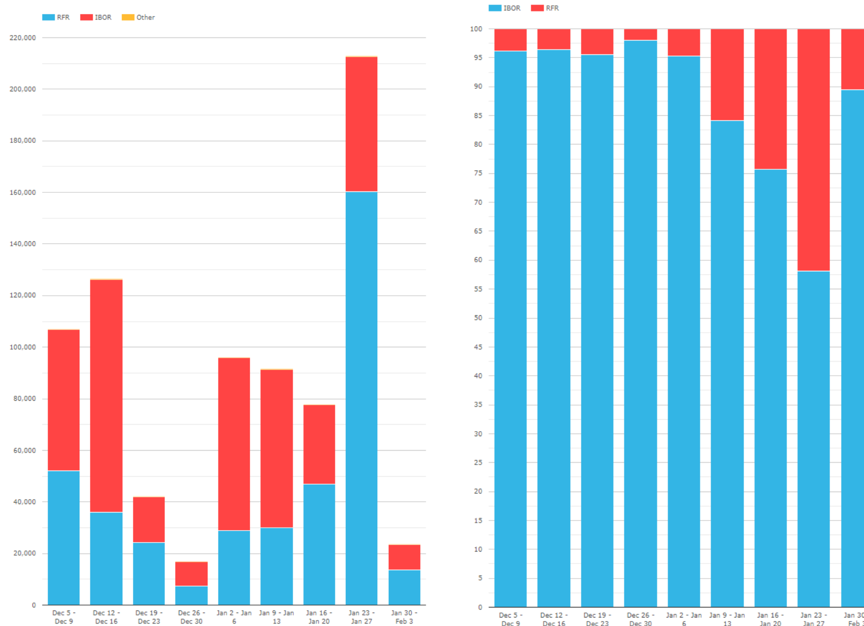
- Selecting D2D platforms changes the data significantly!
  - CORRA First started on Monday Jan 9th 2023.
  - We can see that every week since, the proportion of activity traded versus CORRA has gradually increased in D2D markets.
  - The week of Jan 9th saw 35% of notional traded versus CORRA.
  - This has increased every single week since – 57%, 75% and now 85% so far at the end of January.
  - That is a pretty compelling uptake of RFRs by Canadian dealers!
- Oh, Canadian Clients
- Oh, Clients. Why are you so slow to change? Do you not read our blogs? I think that must be it – Clarus has to do more to improve our readership amongst the buyside. Dealers are clearly aware of CORRA First. And whilst, yes, it is focused on dealer markets, Clients would be well-served to sit-up and take note as well. Afterall, liquidity continues to be the primary consideration, right?
- The same chart for D2C SEFs (i.e. Tradeweb and Bloomberg) looks VERY different:



- Showing;
  - The number of trades transacted on D2C SEFs in CAD markets each week, split by IBOR (CDOR) and RFR (CORRA).
  - The chart looks a bit silly on a percentage basis because the RFR basically never trades on D2C platforms.
  - We did see 35 client trades (big whoop!) last week versus CORRA.
  - But we haven't had a single one yet this week. Doh.
- Global View
- SDR data provides a good insight into the CAD market due to the large footprint of "US Persons" in the market. It is also worth cross-checking the results versus the global cleared market in CCPView.
- Here, we see a huge amount of notional traded in OIS vs CORRA last week – a very positive sign for CORRA First!

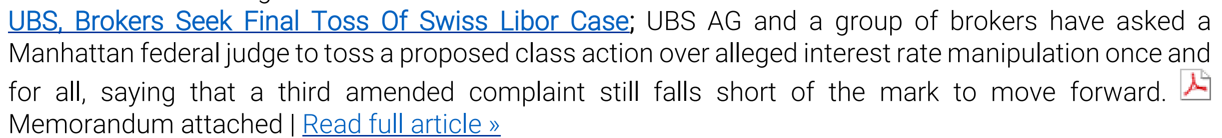


- But a cross-check versus the tenors traded shows that most of this OIS volume was in 2Y tenors (and shorter):
- SEFView; SEFView shows the activity in CAD markets executed on-SEF. We can see a huge amount of notional CORRA was traded last week:
- This also translates into a record week when measured by DV01:



- We already know from the SDR data that this increase in RFR activity is mainly coming from D2D activity. It is a start.
- In Summary
  - CORRA First has started in CAD markets.

- There is strong evidence in the data that the initiative has changed trading behaviour.
- Recent changes in the transparency regime result in a much better understanding of changes such as CORRA First.
- D2D markets are leading the way in CORRA adoption.
- The data can be complex. Markets benefit from standardised measures to track these changes.



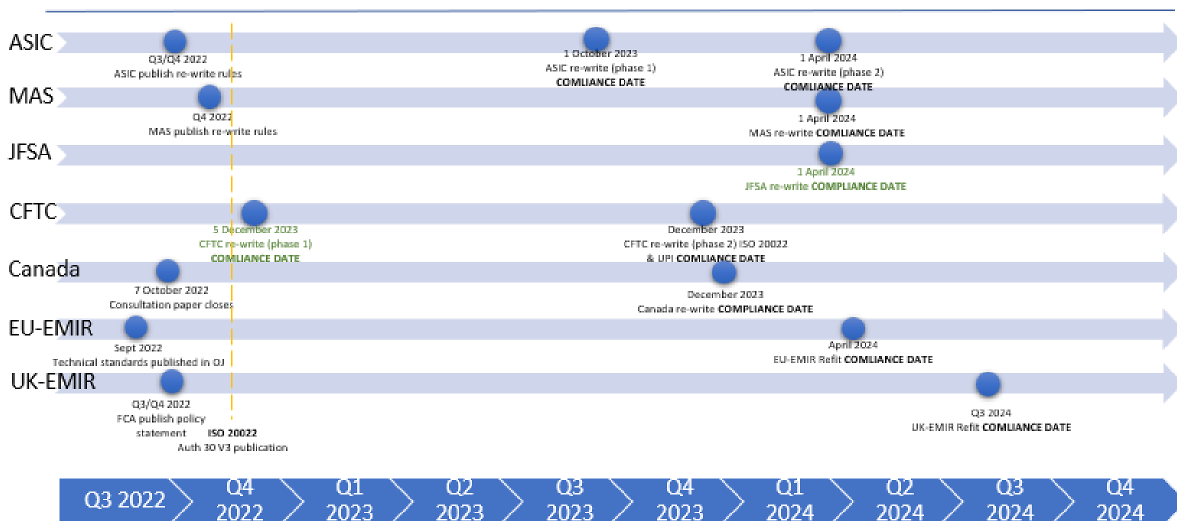
UBS, Brokers Seek Final Toss Of Swiss Libor Case; UBS AG and a group of brokers have asked a Manhattan federal judge to toss a proposed class action over alleged interest rate manipulation once and for all, saying that a third amended complaint still falls short of the mark to move forward. Memorandum attached | Read full article »

Data shines light on Tibor fragility Lack of actual transactions in D-Tibor should be considered in fallback discussions; In Japan, yen Libor was killed off partly because it was too reliant on expert judgement, and the rates market moved largely onto transaction-based overnight rates. But two other interbank offered rates used domestically survive, despite having no transaction volume at all. While that might look like a recipe for disaster in the post-Libor world, it's not quite that straightforward. The two benchmarks in question are the Japanese yen Tokyo Interbank Offered Rate, or D-Tibor, which reflects.

Attys Seek $4.5M Award In Yen-Libor Benchmark-Rigging Suit

Trader Blasts Deutsche Bank For 'Malicious' Libor Prosecution

Conduct News over February 2023



Public Register for the Trading Obligation for derivatives under MiFIR
Public Register for the Clearing Obligation under EMIR

MAR

On 3 February 2023, HM Treasury published the following collection of Fundamental Elements documents produced by the G7 Cyber Expert Group since 2016:

- G7 Fundamental Elements of ransomware resilience for the financial sector (dated October 2022)
- G7 Fundamental Elements for third party cyber risk management in the financial sector (dated October 2022)
- G7 Fundamental Elements for Threat-LED Penetration Testing (dated October 2018)
- G7 Fundamental Elements for third party cyber risk management in the financial sector (dated October 2018)
- G7 Fundamental Elements for Effective Assessment of Cybersecurity in the financial sector (dated October 2017)

BoE publishes CBEST thematic findings; *On 31 January 2023, the Bank of England (***BoE***) published a letter sharing the thematic findings from the latest annual cycle of CBEST assessments conducted by the BoE, the Prudential Regulation Authority (***PRA***) and the FCA (***FCA***) (collectively, the* ***regulators****) on participating banks, insurers, asset and investment managers and financial market infrastructure. CBEST focuses on an organisation's security controls and capabilities when faced with a simulated cyber-attack.*

- The regulators analysed the outcomes of the CBEST assessments and identified trends and findings descriptive of the sector's current cyber posture. These findings are being shared so that firms can take note of the weaknesses identified and thereby address any potential similar weaknesses they may have themselves. The regulators also hope to raise awareness in firms' senior executive teams and to inform the work of firms' risk and audit functions.
- The findings may also be used by the regulators to structure future supervisory interaction and understand the level of engagement firms have achieved with the senior executive team, risk and audit functions on the issues identified as in need of remediation.
- For firms that have participated in the latest CBEST cycle, the remediation plans that have been agreed with supervisors will remain the primary focus for addressing their cyber resilience issues, although the thematic CBEST findings may provide additional information that can be incorporated into those plans.

AFME has issued a position paper on amendments to the Anti-Money Laundering Regulation (AML-R) ahead of the EP ECON Shadow meeting. *AFME has consistently advocated for a harmonised, proportionate, sustainable and risk-based approach to the EU's future AML/CTF framework package. The importance of preventing the malign effects and costs of money laundering and terrorist financing throughout the Union is paramount.*

- However, we consider that some AML-R drafting positions are restrictive and materially misaligned when compared to other international AML/CTF standards, recommendations, and risk-based guidance informed by the Financial Action Task Force (FATF). Several key proposals may also result in significant costs and operational complexity for international businesses, with perceived limited efficacy and effectiveness in practice.

afme/ Finance for Europe

Association for Financial Markets in Europe

AFME position paper on amendments to the Anti-Money Laundering Regulation (AML-R)

30th January 2023

The Association for Financial Markets in Europe (AFME) welcomes the progress the co-legislators are achieving towards the finalisation of the EU (European Union) AML/CTF framework.

This note provides views on the AML-R amendments to the EC (European Commission) proposed text (amendments proposed by various MEPs and published in July 2022) and on what we understand is the approach the EP negotiating team is considering in the context of their work on compromise amendments. At the same time this note also makes reference, where relevant, to the direction of travel in the Council of the EU, as defined in their general approach (published in December 2022).

In particular, we focus on the following priority issues, which are crucial to ensure a harmonised, proportionate, sustainable and risk-based approach to the EU's future AML/CTF framework:

- **Article 42 - Identification of beneficial owners:** the proposal to lower the threshold from 25% to 5% is not only a significant deviation from the FATF's internationally agreed standards, but introduces higher operational complexity and administrative burden, and diverts critical resources away from ensuring effective controls.
- **Article 44 - Beneficial ownership information:** the proposal is inconsistent with the FATF's international standards and disregards the risk-based approach. The proposal will lead to duplicative, costly, and operationally complicated implementation for Obliged Entities.
- **Article 47 - Nominee shareholders and nominee directors:** we are concerned with proposals relating to the prohibition of nominee shareholders and nominee directors, which will have a significant effect on legitimate non-financial business professionals. We suggest Commission refer to the FATF draft guidance on recommendation 24. Which provides helpful measures to ensure no misuse of the nominee shareholders and nominee directors.

The annex provides more specific views on the above-mentioned priority issues.

AFME stands ready to provide additional views.

- **The July amendments 744, 745, 746, 747 and 748 proposes amendment to the introductory part of Article 42 point 1**. Our Members consider that the definition of 'beneficial owner' should not include the notion of "benefiting from" when referring to a business relationship. Such wording unnecessarily broadens the scope of the BO definition and does not recognise that there could be individuals who benefit from the company but who are not technically a BO of the company.
- Furthermore, it is likely that such significant burdens, which are misaligned with globally applied AML/CTF standards, may affect commercial and competitive elements of EU capital markets and EU financial services (within the Union, and operating overseas via branch and subsidiary networks).

2. Article 44 - Beneficial ownership information

- We welcome **amendment 511**. However, **we do not support the position in the current compromise text**. We note that in certain jurisdictions, asking for a residential address is not mandatory. We are of the view that collecting name, surname, date and place of birth and the country of residence are sufficient to check the customers identity.
- Also, we notice that the amendment is incompatible with a risk-based approach. We consider that the identification requirements should be flexible and based on the individual risk level of customers.
- We are of the view that the requirement in Article 44 is misaligned with the FATF's internationally applied AML/CTF standards, and will lead to duplicative, costly, and operationally complicated implementation for Obliged Entities.

3. Article 47 - Nominee shareholders and nominee directors

- **We strongly oppose the amendment 830 and the current compromise text.** We are concerned with the proposals relating to prohibition of nominee shareholders and nominee directors. While we understand that nominees can be used for concealing the identity of criminals, we note that there are many regular, non-criminal situations where nominee shareholders (e.g., financial custodians, fund managers, financial advisors) hold equity or depositary receipts representing equity on behalf of underlying beneficial owners/investors for legitimate service-based purposes, not just to conceal true beneficial ownership. Nominee directors may also be legitimate designated non-financial business professionals representing their clients (e.g., accountants, services providers, lawyers etc). We do not believe the intention here is to exclude these legitimate non-financial business professionals, however, if this was the intention, we would strongly advise a comprehensive cost/ impact assessment on those affected businesses.
- The FATF draft guidance to recommendation 24 provides several measures that countries should adopt to stop money laundering and terrorist financing as against completely prohibiting the nominee shareholders and nominee directors. FATF has helpfully defined the nominator, nominee, nominee director and nominee shareholder and stated that countries should require nominee shareholders and directors to be licensed and to disclose their nominee status and the identity of their nominator. We suggest adopting these definitions and adding provisions regarding transparency and licensing for the nominees to prove their legitimacy.

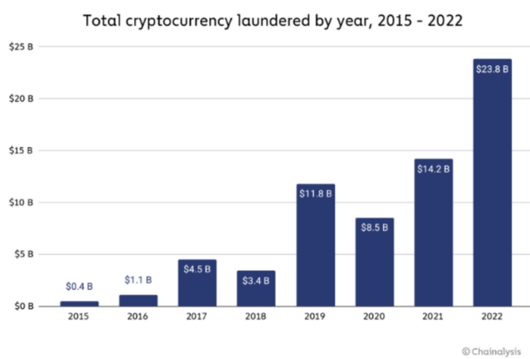
Jersey Regulator Appoints AML Supervisor The Jersey Financial Services Commission has hired David Eacott as its executive director of supervision, the watchdog's leading man on anti-money laundering matters in the island's financial services sector. Read full article »

Barclays probed by UK regulator over anti-money laundering systems; FCA review is latest problem for lender that has struggled with compliance missteps in recent years; Barclays is being probed by the UK financial regulator for suspected persistent failings in its compliance and anti-money laundering systems, according to people with knowledge of the matter. The Financial Conduct Authority issued a notice last spring requiring an independent review of the lender's systems to prevent and detect financial crime after becoming concerned about the amount of know-your-customer and AML incidents, the people said. /jlne.ws/3DYKw9o

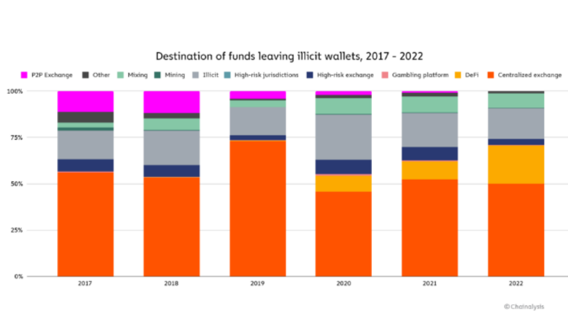
Crypto Money Laundering: Four Exchange Deposit Addresses Received Over $1 Billion in Illicit Funds in 2022; *Money laundering is crucial to all financially motivated crime because it's what enables criminals to access the funds they generate from their activities. Otherwise, why commit the crimes in the first place? The same is true in cryptocurrency. The goal of money laundering in cryptocurrency is to move funds to addresses where its original criminal source can't be detected, and eventually to a service that allows cryptocurrency to be exchanged for cash — usually this means exchanges. If that weren't possible, there would be very little incentive to commit crime involving cryptocurrency.*

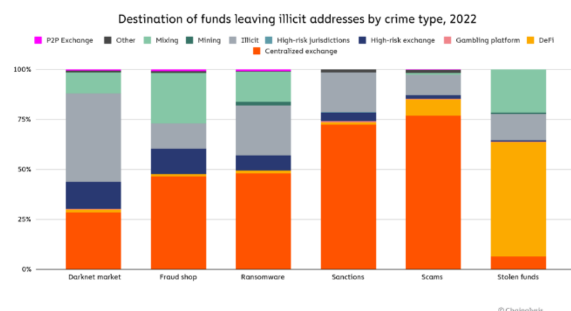
- Money laundering activity is highly concentrated to just a few services, and within those services, concentrated even further to a small number of deposit addresses. That remained true in 2022, though as we'll explore, with a few new wrinkles. In addition, we'll examine the rise of underground money laundering services that exist separately from the crypto businesses most are familiar with, and also analyze funds still held by crypto criminals on the blockchain.

- 2022 crypto money laundering activity summarized; Money laundering in cryptocurrency typically involves two types of on-chain entities and services:
- Intermediary services and wallets: These can include personal wallets (also known as unhosted wallets), mixers, darknet markets, and other services both legitimate and illicit. Crypto criminals typically use these services to hold funds temporarily, obfuscate their movements of funds, or swap between assets. DeFi protocols are also used by illicit actors in order to convert funds but, as we will discuss, are not an efficient means of obfuscating the flow of funds.
- Fiat off-ramps: This refers to services that allow for cryptocurrency to be exchanged for fiat. This is the most important part of the money laundering process, as the funds can no longer be traced via blockchain analysis once they hit a service — only the service itself would have visibility into where they go next. Additionally, if the funds are converted into cash, they can only be followed further through traditional financial investigation methods. Most fiat off-ramps are centralized exchanges, but P2P exchanges and other services can also serve this function.
- With that in mind, let's look at some of the money laundering trends we saw in 2022.



Overall, illicit addresses sent nearly $23.8 billion worth of cryptocurrency in 2022, a 68.0% increase over 2021. As is usually the case, mainstream centralized exchanges were the biggest recipient of illicit cryptocurrency, taking in just under half of all funds sent from illicit addresses. That's notable not just because those exchanges generally have compliance measures in place to report this activity and take action against the users in question, but also because those exchanges are fiat off-ramps, where the illicit cryptocurrency can be converted into cash.





- More illicit funds were sent to DeFi protocols than ever before, a continuation of a trend that began in 2020. Cybercriminals send funds to DeFi protocols not because DeFi is useful for obscuring the flow of funds. In fact, quite the opposite is true, as unlike with centralized services, all activity is recorded on-chain. Keep in mind too that DeFi protocols don't allow for the conversion of cryptocurrency into fiat, so most of those funds likely moved next to other services, including fiat off-ramps. And as we see below, almost all usage of DeFi protocols for money laundering is carried out by one criminal group hackers stealing cryptocurrency.

- Hackers holding stolen cryptocurrency are the only criminal category sending the majority of funds to DeFi protocols, at a whopping 57.0%. 2022 was an enormous year for hacking, hence why these cybercriminals were almost single-handedly able to drive the overall increase in the usage of DeFi protocols for money laundering. The fact that DeFi protocols themselves were the biggest target of hacks in 2022 also influences these numbers. In DeFi hacks, attackers often end up with tokens that aren't listed on other exchanges, so they need to use decentralized exchanges (DEXes) to swap them for more liquid crypto assets. DEXes have historically been used to convert funds to Ether, which can then be sent to Ethereum-based mixers. DEXes have also been used to convert to assets that will be more likely to hold their value, or in the case of stablecoins, to swap to an asset that cannot be frozen by the stablecoin issuer. However, as noted previously, DEXes don't enable the conversion of funds from cryptocurrency to fiat currency — this must still be done through a centralized exchange or other fiat off-ramp.
- Aside from hackers, crypto criminals send the majority of their funds directly to centralized exchanges, but there are some notable exceptions. For instance, darknet market vendors and administrators send most of their funds to other illicit services — primarily other darknet markets, some of whom may offer money laundering services similar to those of the now-shuttered Hydra Market. Darknet market addresses also sent a large share of funds to high-risk exchanges, such as Bitzlato, a Russia-based exchange shut down in an international law enforcement action recently for its money laundering activity. Ransomware attackers are another interesting case. Addresses associated with them send a disproportionately large share of funds to mixers, and also make heavy use of illicit services. Fraud shop vendors and administrators are also notable for their outsized mixer usage.
- In total, we see that over half of funds sent from illicit addresses travel directly to centralized exchanges, both mainstream and high-risk, where they can be exchanged for fiat unless compliance teams take action. However, over 40% of illicit funds move first to intermediary services — primarily mixers and illicit services or DeFi protocols —, with most of those funds coming from ransomware, darknet market, and hacker addresses.

On 10 February 2023, the Wolfsberg Group published version 1.4 of the Correspondent Banking Due Diligence Questionnaire (CBDDQ) and version 1.2 of the Financial Crime Compliance Questionnaire (FCCQ), along with updated supporting Guidance, Glossary and FAQs documents.

- The CBDDQ update includes a new section on fraud and additional questions related to whistleblower policy, virtual bank license, the approval of sanctions policy. Other changes have been made to improve the logic, usability, and flow of the questionnaire. Commensurate changes have also been made to the FCCQ to ensure consistency.
- The FAQ and Glossary documents have been updated to address changes in the questionnaires. Notably, in the FAQs, the recommended timeframe for update of the questionnaires has been adjusted to 12-18 months.

On 6 February 2023 the three European Supervisory Authorities (ESAs) held a joint public hearing on the implementation of Regulation (EU) 2022/2554 on digital operational resilience for the financial sector ("Digital Operational Resilience Act" or DORA).

- As per a follow up press release, the event – held online – gathered over 2,000 representatives from credit and payment institutions, investment firms, (re)insurance undertakings, ICT third-party service providers and other financial entities. The focus of the joint hearing was to provide an opportunity for industry participants to engage with

regulators on the new legislation, share their initial views and raise any potential areas of concern regarding the policy mandates that the ESAs have to develop over the course of 2023 and 2024.

- In its opening presentation, the European Commission provided a high-level overview of DORA and the background to the legislation. In their joint presentation that followed, the ESAs provided a complete overview of all DORA implementing technical standards (ITSs) and regulatory technical standards (RTSs) that they are mandated to develop, and they provided an indicative timeline for the upcoming work, including an indicative timeframe for the upcoming industry consultation. Accordingly, the ESAs planning depends on the length of time it has to submit drafts to the Commission and their deadlines for doing so:
    - Deadline 17 January 2024 (including RTSs for risk management framework, ICT policy, classification of major ICT incidents, ITS on the register of information): public consultation to take place between mid-June 2023 and September 2023.
    - Deadline 17 June 2024 (including RTSs on sub-contracting, reporting of major ICT incidents): public consultation to take place between November 2023 and February 2024.
- In addition, the ESAs plan to hold a targeted public consultation in May 2023 on the content of their technical advice to the Commission on the criteria for assessing criticality of ICT third-party service providers.
- On 4 January 2023 the European Banking Authority (EBA) published a letter from the European Commission ("the Commission") to the European Supervisory Authorities (ESAs) requesting advice on designation criteria and fees for the oversight framework for critical third-party service providers set out under Regulation (EU) 2022/2554 on digital operational resilience for the financial sector (DORA). Together with the letter, the EBA published the content of the Call for Technical Advice, which sets out in more detail the scope of the advice requested by the Commission. As per the mandate set out in DORA, the ESAs are requested to deliver technical advice on two delegated acts:

1. Delegated act specifying the amount of fees to be collected from critical third-party service providers; and
2. Delegated act specifying the criteria for assessing criticality. In respect of this delegated act the ESAs are requested to specify the relevant indicators of a qualitative and quantitative nature of each of the four criteria to determine criticality of third-party service providers as set out in DORA and including:
3. The systemic impact on the stability, continuity or quality of the provision of financial services in the event that a critical third-party service provider would face a large-scale operational failure to provide its services.
4. The systemic character or importance of the financial entities that rely on a critical third-party service provider.
5. The reliance of financial entities on the services provided by a critical third-party service provider; and
6. The degree of substitutability of a critical third-party service provider.

- The deadline for the ESAs to deliver the technical advice is 30 September 2023. DORA will become applicable on 17 January 2025.

The financial system is alarmingly vulnerable to cyber attack; Derivatives traders tend to watch the US CFTC closely on a Friday. This is the day the CFTC normally releases its weekly "commitments of traders" report showing overall positioning in derivatives markets, such as oil

futures. This month, however, the data has been missing in action because a small, publicity-shy data group called Ion Markets - headquartered in Dublin but used by dozens of American and European players - suffered a ransomware attack on January 31. /jlne.ws/3YSOUzj

FRB Governor Warns Banking Industry of Third-Party Cybersecurity Risks' *Federal Reserve Board ("FRB") Governor Michelle W. Bowman cautioned banks about cybersecurity risks related to third-party technology firms and stressed the responsibility of banks to manage these risks.*

- In remarks at the Midwest Cyber Workshop, Ms. Bowman said that the demand for innovative and personalized products and services has increased reliance on third parties. This, she said, could expose banks to an increased risk of cyberattacks, including ransomware or exploitative hacks through third-party or external applications. Speaking on the substantial rise in the frequency of ransomware attacks, Ms. Bowman said that banks will be better positioned to handle such attacks by using a "robust, formal risk assessment process" to establish a "comprehensive action plan." Ms. Bowman also addressed obligations for banking organizations under the FRB's recently adopted computer security notification rule (*see* related coverage), which requires banks to report cyber incidents.
- Ms. Bowman emphasized that utilizing third parties to provide products and services to customers does not relieve banks of the responsibility to conduct their activities in a sound manner, and that banks must conduct thorough oversight of any third party to ensure that it operates in compliance with applicable banking regulations. She said that banks should continue utilizing third-party services to keep pace with innovation, but cautioned that a bank should only do so if it is well equipped to mitigate the associated risks.
- FRB Governor Michelle W. Bowman: Welcoming Remarks at the Midwest Cyber Workshop

BIS Innovation Hub eyes data-driven approach for AML The BIS Innovation Hub's Nordic Center is studying ways to use data technologies that include machine learning for detecting false positives in fighting money laundering at financial institutions. BIS Innovation Hub says spotting money laundering patterns "is complex, requiring different data points and data sources as well as the ability to connect them across different systems in order to better identify suspicious flows and patterns." Regulation Asia

Senate Banking holds digital assets hearing. On February 14th, the Senate Banking Committee held a hearing entitled "Crypto Crash: Why Financial System Safeguards are Needed for Digital Assets." The committee heard from three academics on the causes underlying digital asset volatility over the last year and potential policy solutions such as a clear regulatory framework including enhanced rules around consumer protection, insolvency, AML and sanctions. The witnesses also discussed the options of granting the SEC authority over spot markets and developing self-regulatory organizations for digital asset exchanges.

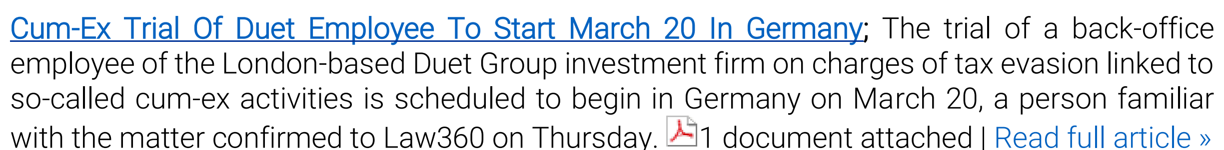
- House Financial Services Committee Chair Patrick McHenry (R-NC) and Representative Blaine Luetkemeyer (R-MO) submitted a comment letter to Treasury Secretary Janet Yellen and FinCEN Acting Director Himamauli Das criticizing FinCEN' s proposed rule concerning access to, and protection of, beneficial ownership information (*see* related coverage).
- The letter highlighted specific concerns with the level of disclosure and privacy protections included in the proposed rule and the conditions under which financial

institutions could access the beneficial ownership information that FinCEN collects. The Representatives said that small business beneficial ownership information should be treated similarly to individual tax return information as set forth in 26 U.S.C. 6103 ("Confidentiality and Disclosure of Returns and Return Information"), and argued that FinCEN's proposal, as currently written, deviates from the statute and congressional intent.

- The Representatives also proposed that FinCEN establish a process that makes clear when a business has provided consent to a financial institution to access its beneficial ownership information and when that consent has been revoked.
- House Financial Services Committee Majority Letter: Department of the Treasury's Notice of Proposed Rulemaking Titled "Beneficial Ownership Information Access and Safeguards"
- House Financial Services Committee Majority Press Release: McHenry, Luetkemeyer Send Comment Letter Rebuking FinCEN's Proposal Regarding Access to Beneficial Ownership Information

Ex-Goldman Banker Argues 1MDB Bribes Only $1 Billion, Not $2 Billion; Roger Ng is set to be sentenced for role in scandal next month; Prosecutors say he is still trying to litigate facts of case; Former Goldman Sachs Group Inc banker Roger Ng is disputing the amount in bribes that were paid during the 1MDB scandal ahead of his sentencing for conspiring to loot billions of dollars from the Malaysian sovereign wealth fund. Ng, who is set to be sentenced on March 9, said in a sealed reply to a government presentencing report filed in federal court in Brooklyn, New York, that $1.1 billion was paid to corrupt officials including former Malaysian prime minister Najib Razak. /jlne.ws/3xrlNqD

How did Hindenburg short Adani stock? People familiar with the firm's modus operandi say it may have used single stock futures and the help of western banks in Singapore; When US short seller Nathan Anderson decided to take on Indian conglomerate Adani Group, he faced the ultimate challenge for someone in his line of business: India's anti short selling rules. The founder of New York-based Hindenburg Research has not detailed how he structured his financial bet against the infrastructure group, which he has accused of fraud and stock price manipulation in a 100-page report published last month - saying only that the firm had taken a short position in Adani "through US-traded bonds and non-Indian-traded derivative instruments". /jlne.ws/3Ixy0QQ


Cum-Ex Trial Of Duet Employee To Start March 20 In Germany; The trial of a back-office employee of the London-based Duet Group investment firm on charges of tax evasion linked to so-called cum-ex activities is scheduled to begin in Germany on March 20, a person familiar with the matter confirmed to Law360 on Thursday. 1 document attached | Read full article »

Proposed UK failure to prevent fraud offence: What do you need to do now?; *February 2022 it was confirmed that a new UK offence of failure to prevent fraud will be progressed as a priority, following the UK Law Commission report on corporate criminal liability in 2022. The UK Government is planning to introduce the offence as an amendment to its Economic Crime and Corporate Transparency Bill. The proposed offence forms part of broader reforms of corporate criminal liability in the UK (discussed in more detail here).*

- Although the details of the offence are still to be clarified, a failure to prevent fraud offence will change the landscape for fraud investigations and compliance in the UK. In particular, it will shift the focus from companies as victims of fraud (inward fraud) to make it easier for companies to be prosecuted for fraud by employees or third parties that the company benefits from (outward fraud). It will also require many companies to make significant changes to fraud compliance programmes to cover outward fraud.
- We have been receiving various questions from clients on the proposed offence. In this blog we explore some of the most common questions, explaining what the new offence will likely cover, when it will come into force, and how companies can prepare in the meantime.
- Over the coming weeks, we will be publishing a series of blogs considering in more detail the scope of potential offences, the types of fraud which may be caught, and the broader implications.
- **What will the new offence look like and what are the implications?**
- It is likely that under the proposed offence of failure to prevent fraud, a company would be criminally liable for fraud where:

1. an **associated person of a company** (which is likely to be defined broadly and include employees, subsidiaries, service providers and intermediaries) commits an offence of fraud; and
2. the offence was **for the benefit of the company**, or a person to whom services are provided on behalf of the company.

- Similar to the UK Bribery Act, it is likely to capture companies carrying on a business in the UK as well as UK companies and the only defence is likely to be where the company can show it had in place "adequate" or "reasonable" procedures to prevent fraud.
- The proposed offence is significantly broader than the current position, in which companies are only criminally liable for fraud where a directing mind and will of the company, e.g. a very senior executive or director, has been personally involved in the fraud.
- Given the significant increase in civil claims alleging fraud (see our commentary here and here), we expect to see companies increasingly facing parallel civil fraud proceedings and criminal investigations. There is also likely to be a greater risk for companies of private prosecutions brought by victims of the fraud.
- **When will the new offence come into force?**
- We would expect that the new offence will come into effect in 2024 to allow for guidance on "adequate" or "reasonable" fraud procedures (similar to the Ministry of Justice Adequate Procedures Guidance in relation to the UK Bribery Act) to be prepared and issued.
- **What do companies need to be doing now?**
- We have set out below five key steps companies can take to begin to prepare for the new offence (and to manage fraud risk generally):

1. **Risk assessments:** companies should conduct fraud risk assessments (or adapt existing fraud risk assessments), ensuring the risk of both inward and outward fraud is assessed.
2. **Policies and procedures**: businesses will need to ensure that they have in place and can demonstrate reasonable (and risk-based) procedures to prevent fraud. Existing policies and procedures should be supplemented based on the results of the risk assessment.

3. **Training**: companies should update their fraud training, making sure that this includes outward as well as inward fraud by reference to real life examples (ideally those faced by the company or its peers). Tailored training for employees in higher risk positions should be considered.
4. **Due diligence:** companies should enhance existing third party and M&A due diligence processes to include outward fraud risks and ensure that appropriate fraud-related contractual protections are put in place.

- **Monitoring and review**: as companies build or supplement their fraud compliance programmes they should ensure that monitoring and review processes (e.g. transaction testing, sample auditing) cover both inward and outward fraud.

German Anti-Financial Crime Alliance to be continued after successful pilot phase; *The Anti-Financial Crime Alliance (AFCA) will continue its work permanently after a successful three-year pilot phase, following a decision by the AFCA board. Since September 2019, the AFCA has been providing its members and all obliged persons under the German Money Laundering Act (GwG) with valuable insights on current issues and assistance (e. g. white papers, reference papers).*

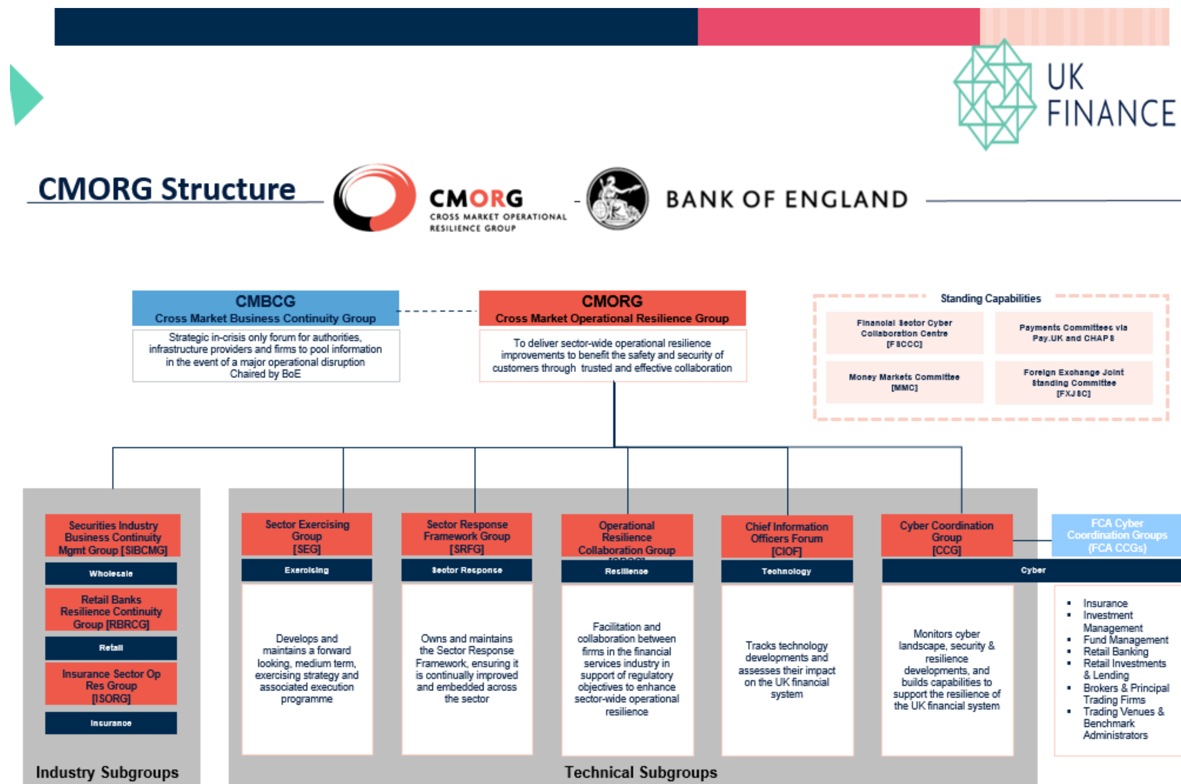
- The AFCA is a German public-private partnership which supports coordinated and long-term strategic cooperation in combating money laundering and terrorist financing. The German Federal Financial Supervisory Authority (BaFin) is a member of the AFCA and is represented on the board by its Chief Executive Director of Resolution and Prevention of Money Laundering, Birgit Rodolphe.

DOJ charges traders with Brazilian bribery scheme; The US Department of Justice has brought bribery, money laundering, and conspiracy charges against Connecticut oil and gas trader Glenn Oztemel and Brazilian-Italian oil and gas broker Eduardo Innecco over an alleged scheme involving Brazil's state-owned oil company Petrobras. The DOJ alleges that the defendants bribed Brazilian officials to win contracts with Petrobras between 2010 and 2018. Reuters (2/17), The Wall Street Journal (2/17), Bloomberg Law

CFTC Charges Crypto Firm and CEO with Operating "Ponzi" Scheme

Investment scam reports rise by 193% cent in five years; Financial watchdog notes growth of crypto fraud Siddharth Venkataramakrishnan - Financial Times
Calls to the UK financial watchdog related to investment scams have nearly tripled over the past five years, as fraudsters use inflationary pressures to better target victims. The data reflects the wider growth of so-called authorised push payment fraud, in which consumers are tricked into sending money to scammers who pose as trusted figures. "Scammers are becoming more and more sophisticated, coming up with different tactics, such as impersonation texts or calls, and using the cost of living pressure as a way to tempt investors into false opportunities," said Mark Steward, executive director of enforcement and market oversight at the FCA. /jlne.ws/3ErQ64u

Trafigura exposure to alleged fraud firms dates back to 2015 Trafigura traded with firms linked to Indian businessman Prateek Gupta since 2015, a company spokesperson has said, as the commodity trading house continues to work to clarify its exposure to alleged fraud it says was led by Gupta and his companies. "A number of red flags led to our making efforts to reduce our exposure to companies owned by UD Group and TMT Metals," said a Trafigura spokesperson. "Any fraud is an opportunity to review and tighten systems and procedures and a thorough review is under way." The Wall Street Journal



BOE and FCA are reviewing the Cyber Co-ordination Groups in general. EVIA shall continue participation on TACIG when it next meets in May/June, which shall allow for any rationalisation of these groups and format.

- Incident Reporting Update – As discussed in the meeting Firms are required to notify the FCA of material operational incidents as part of SUP15.3 and Principle 11. This includes technology failure and outages, cyber-attacks and non-technology incidents, such as a power outage or office closures. We track, analyse and respond to incidents that are reported to the FCA.
- The focus of our incident response work is to make sure firms take appropriate steps to mitigate harm, identify the root cause, and to prevent the incident reoccurring.
- Further details can be found at the links -> https://www.fca.org.uk/firms/operational-resiliencereporting-operational-incident
- https://www.handbook.fca.org.uk/form/sup/SUP_15_ann_11_REP018_20180113.pdf - This is the link under FCA Chapter 15 (SUP 15) relating to Payments Service Directive incidents. Still useful to use as a guide though when reporting other non-payment incidents as similar information under the headings will be required. e.g. Nature of the Service incident, Impact, Mitigation and Communication plans.
- Co-Chair Rotation expressions of interest should be sent to Debbie Cassidy (debbie.cassidy@fca.org.uk). If we can receive these by end of November that would be ideal so we can progress with a new co-chair ahead of the Q1 Forum or alternatively send to Julie for onward transmission.

- Once these are received members can vote for the new Co Chair and once process complete ToR will be updated with new process.
- CTP – https://www.fca.org.uk/publications/discussion-papers/dp22-3-operational-resilience-critical-third-parties-uk-financial-sector
- Roze Ahmad roze.ahmad@fca.org.uk for specific questions on presentation but feedback on Discussion Paper should be sent to DP3_22@bankofengland.co.uk

Goldman expects $2.3 billion more in potential losses from legal disputes; Goldman Sachs Group Inc is expecting to incur $2.3 billion more in potential losses from legal proceedings than the reserves it had set aside for such matters last year, a regulatory filing by the investment bank showed on Friday. That was in line with what the bank had estimated at the end of its third quarter in September, but was higher than the $2 billion loss it projected in 2021. Goldman has been a target of lawsuits ranging from its role in Malaysia's 1MDB sovereign wealth fund scandal to the collapse of Archegos Capital Management in 2021. A long-running gender bias lawsuit alleging widespread bias against women in pay and promotions at the Wall Street bank is also expected to head to trial later this year. /jlne.ws/3Y00rLQ

FTX's Bankman-Fried hit with more criminal charges FTX co-founder Sam Bankman-Fried is facing additional criminal charges of bank fraud and making unlawful political contributions to steer regulations for digital assets. The new indictment states that the donations of tens of millions of dollars were done through "straw" donors to avoid political contribution limits. Reuters BNN Bloomberg The Wall Street Journal Financial Times

Trafigura offered $15mn from alleged nickel fraudster using Mauritian bank

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SupTech, RegTech & FinTech

Podcast on HM Treasury proposals for the UK's financial services regime for cryptoassets; On 1 February 2023, HM Treasury issued its latest proposals for the UK's financial services regime for cryptoassets. It also issued a policy statement on its approach to the regulation of cryptoasset financial promotions. In this podcast Jonathan Herbst is joined by Albert Weatherill and Hannah Meakin who provide their views on the key headlines including scope, authorisation, timing and process.

AI: Big Thought Alert... I am starting to think that the AI moment we are seeing, and in particular Chat GPT, is one of the biggest deflationary shocks in all history... Akin to China joining the WTO (actually bigger as low wages were not persistent in China).

- We will look back on this moment and realize everything changed... The cost of "expertise" in many, many cases has just collapsed to zero, near instantly And it has only just started... in 5 years' time it will have eaten almost everything. Different opportunities will arise though.
- How do you feel about an AI doctor? Driving the news: ChatGPT recently passed all three parts of the U.S. Medical Licensing Examination, although just barely, as part of a recent research experiment. (Axios)

ChatGPT's New Tool for Detecting Text Written by AI Doesn't Work Very Well (BBG) Teachers have been struggling to cope with rise of ChatGPT

- The founder of Gmail Paul Buccheit claims that ChatGPT can "kill" Google in two years.

- CHATGPT: Sam Altman (CEO of OpenAI): "we know that ChatGPT has shortcomings around bias, and are working to improve it. but directing hate at individual OAI employees because of this is appalling. hit me all you want, but attacking other people here doesn't help the field advance, and the people doing it know that. we are working to improve the default settings to be more neutral, and also to empower users to get our systems to behave in accordance with their individual preferences within broad bounds. this is harder than it sounds and will take us some time to get right."

Europe is losing the AI battle; *Having missed the first stage of the digital revolution, Europe is now in danger of missing the next big phase: that of artificial intelligence, a technology that is now experiencing explosive growth. The US is leading, followed by China, and this is pretty much it.*

- The German government has commissioned a study on large European AI models, which argues that unless the EU can develop its own technology, it will become dependent on the US, which would also mean dependence on a lower standard of data protection. The problem is that Europeans see artificial intelligence as a threat against which they want to protect themselves. It is hardly surprising that they are not the lead developers.
- Can we stay outside and be happy? The problem is that ordinary companies will eventually need to buy AI-service and technologies to stay competitive. This is exactly what is now happening with digital technologies, which Germany in particular was reluctant to adopt. We recall when some large German companies deluded themselves in the 1990s that they could out-compete digital technologies through sophisticated analogue technology. Remember Francois Mitterrand's and Helmut Kohl's high-definition television? The EU is committing the same mistake on AI.
- The issue is not research. Many of the world's top AI researchers are European. The problem is computing power. Microsoft is about to invest $10bn into OpenAI, an open-source AI lab. The German government has a budget of €3bn to invest into a whole series of small projects. The problem is that the technology is moving at a faster speed than the debating schedule in the Bundestag.
- The US is dominating the global market for cloud servers, which is already causing problems with the data protection standards for Europeans. With AI, the problem will be so much worse. If there is no domestic capacity, the EU will lose its regulatory powers.
- What will need to happen would be a massive catch-up programme, but high-capacity computing costs billions to develop. When we read the report in ARD Tagesschau, we can already see why the German and the European approach is not working. There are several domestic and EU kick-starter initiatives that operate at a small scale. And we don't see political leaders turning this into a high-priority matter. At least Kohl and Mitterrand were interested in technology. They just bet on the wrong one.
- The politics has not changed either. In Germany, the CDU is in favour of de-regulation, but the Greens, who run the economics ministry, want to prioritise data protection. This is why we are where we are. The headline of the ARD article is: Will Germany be left behind in the AI boom? The article tries its best to be hopeful. But we see this as a triumph of hope over experience.

Paul Krugman had some views about the Argentinian/Brazilian currency union news. He's not a fan

Commission: Why do we need a global approach to regulating crypto-assets? : The rapid development of crypto-assets within the financial system over the last few years is a tale about how authorities can encourage innovation whilst ensuring proper risk management for the sake of investors

Finextra: UK Government outlines plans to regulate cryptoasset industry : Consultation proposals include strengthening rules for crypto trading platforms and a "robust world-first" regime for crypto lending by tightening the rules around financial intermediaries and custodians.

City AM: UK crypto hub ambitions at risk if it does not pass new rules quickly, experts warn : Whilst there is still a way to go before new rules come into force, we're encouraged by the scale of the government's ambition…

EIB issues its first ever digital bond in pound sterling : The EIB is continuing to spearhead market developments in the digitalisation of capital markets with a fully digitally native bond issuance in pound sterling.

ISDA: Bringing Legal Certainty to Digital Asset Derivatives : The shocking collapse of crypto exchange FTX with the apparent loss of billions of dollars of customer assets, and the subsequent failures of several other high-profile crypto firms, have raised some fundamental legal questions.

BIS: Digital payments make gains, but cash remains : The strong growth in digital payments over the past decade continued in 2021. The volume and value of fast payments reached record levels.

Finance Watch: Kicking and screaming – the Euro arrives in the Digital Age : As development of the digital Euro project begins, policymakers must remember democratic legitimacy and trust are the key ingredients to the process.

The Wallet Wars Are Not About Money, They Are About Identity; *Around the world the transition from physical wallets to digital wallets is well underway. An Accenture survey of 16,000 customers in 13 countries found that 56% of them were using digital wallets more than five times every month (compared with only 48% using cards that often) and they interpret these results to mean that heading towards a hundred billion dollars of annual payments revenues for banks are "at risk".*

- That's big money in anyone's language, so it is not surprising that wallet wars are around the corner and that the US banks are moving their tanks on to Big Tech's lawn with the announcement that Wells Fargo, Bank of America, JPMorgan Chase, and others are developing a digital wallet to help consumers pay at online merchants.
- The banks are on trend, for sure. New research from Mastercard shows that around half of all Brits think that physical wallets will become less relevant, with a fifth of them (and two-fifths of millennials) saying that they do not expect to carry a wallet or a purse within five years. These opinions correlate with the continuing decline of cash. A decade ago around 60% of payments were made in cash, and UK Finance estimates that this figure will fall to 6% by 2031.
- (You might want to short leather, because 41% of Gen Z say they don't expect to ever buy a physical wallet or purse again!)

- This new bank wallet will be managed by Zelle operator Early Warning Services LLC (EWS) and will implement the Secure Remote Commerce (SRC) standard to smooth the payment journey of Visa and Mastercard users during checkout. EWS say that the wallet will include approximately 150 million Visa and Mastercard credit and debit cards connected at launch, with plans to add other card networks in the future.
- (If you've not heard of SRC, don't worry about it. Consumers will see the SRC standard as "Click to Pay", just as they see the EMV standard as "Chip and PIN".)
- SRC is a well-designed and thought-through system, but as Adrian Hope-Bailie observed, it is not perfect. In particular, it is optimised for the payment card experience and is not "well-suited to non-card payment methods". That point is important, because EWS has said that it will explore adding other payment options in the future, including enabling payments **directly from bank accounts** (my emphasis). I think that is a crucial, and initially overlooked, aspect of the announcement because as the widely-respected payments industry observer Tom Noyes reported in his blog, the big US merchants are lukewarm on implementing yet another means of accepting cards whereas one of the top merchants told him "I wanted to accept Zelle, consumers know what that is". Indeed they do, and as I have previously pointed out in my comments about Europe's "third scheme", there are lots of reasons why account-to-account makes sense to consumers and merchants alike.
- (Incidentally there is at least one place where Zelle is accepted by retailers and that is Caracas, where the homemade signs in shop windows reading "Aceptamos Zelle" are common. Pictures of the Zelle logo are taped to cash registers in supermarkets, some of which have dedicated lines for customers paying with the app!)
- Identity and Ownership
- Direct to account or not, there is something else going on with digital wallets that should shape bank strategies, and that is digital identity. The Mobey Forum (which was established back in 2000) is a global, not for profit industry association of banks and other financial institutions who want to shape the future of digital financial services. Their Digital Identity Expert Group has just published a report called "The Rise of Digital Identity Wallets: Will Banks Be Left Behind?", which suggests that a combination of consumers demand, regulatory mandates (such as eIDAS in Europe) and the trend toward digital identity wallet issuance by global governments means that financial institutions must start thinking about the role they wish to stake out in the emerging digital identity ecosystem.
- In particular, Expert Group identity unique opportunities for banks to leverage their position as custodians of personal data to offer value-added digital identity services and become brokers of trust in the digital economy. The report suggests that for digital identity systems to succeed, banks must bridge the divide between the private and public sectors and drive adoption of so-called digital identity wallets.
- This is not a difficult position to justify. There is no cash in my wallet and there has not been for some time. It turns out that I am hardly alone in this respect. A recent poll in the UK found that half the people surveyed said they only carried a wallet to store non-payment cards such as driving licences and loyalty cards (and that it without taking into account the fact that payment cards themselves are an identity product and not money in any sense of the word). In fact, a third of 18–24-year-olds say that the digital wallet on their phone is already their preferred way to pay and more than half would rather just carry their phone in place of a wallet or purse.

Hand over your wallets.

- I can provide two data points to confirm this. First, I can't remember the last time that I took a wallet anywhere, except to watch Woking FC (because my wallet has my season ticket in it) and second, my son recently lost his wallet in a nightclub (because it had his driving licence it, and he needs his driving licence to get into nightclubs). In other words, in both cases we had our wallets with us because we needed them for identity (or, more accurately, credentials), not for payments, which is why the control of wallets will be a fundamental battle of the coming era in commerce and talk of "wallet wars" is far from hyperbole.
- The picture is the same across Europe, where a Thales survey of EU citizens in the seven countries found that two-thirds would use a wallet to store their digital identity (rising to three quarters amongst those who already have some other form of digital ID) although what is probably different from the US here is that two-thirds of Europeans think that a government digital wallet is best, with a third thinking that it should be banks taking the lead. I strongly suspect that in the US the idea of a government wallet is further from the mainstream and private providers—not only banks but also retailers, Big Tech, telcos, brands and other organisations—might be preferred.
- (Frankly, my view that "Apple ID" will be far more disruptive than Apple Pay seems less than radical when Fiserv's consumer trends survey last year found that more than two-thirds of consumers had already used a digital wallet and a global survey from FIS found that digital wallets already account for almost half of e-commerce transaction value. This means something like $2.5 trillion is already flowing from consumer digital wallets to merchants around the world.)
- From my distant and tangential perspective, then, it seems to me that the way for banks to make their wallet indispensable is not to compete with Big Tech on payments, but to focus on identity to expand the ecosystem around their wallet. This is already the strategy of Apple and Google (with mobile driving licences) but surely the banks, with the vast amounts they spend on known-your-customer and so on, can make it core to their offering.
- To choose just one example of how such an ecosystem might grow, the Swiss payment app TWINT (formed from the merger of the bank and Postfinance apps back in 2016) has partnered with the Swiss supermarket chain Migros to develop self-service mini-supermarkets where it will be used initially for access to the shops and in the next phase for "purchasing goods that are age-restricted" (credentials, again).
- Money Talks
- The important point is that a hundred billion dollars here or there notwithstanding, digital wallets—that is, identity wallets—are the big deal. Doc Searls calls them "the biggest instrument of personal agency since the browser" and with characteristic accuracy notes a crucial difference between the leather wallet in my desk drawer (which is where it stays most of them time) and the digital wallet(s) on my smartphone: the physical

wallet belongs to me, but the digital wallet does not, which reinforces the point about control of the wallet.
- But Doc also highlights another difference between physical and digital wallets that has long interested me and is, I think, under-appreciated in strategic terms. He says that physical wallets are containers of cash, credentials, receipts, and other bits of paper but notes that they do not "engage or operate with other parties" (or, I might add, with each other).
- In other words, my physical wallet is deaf and dumb. But my digital wallet can communicate locally with the software agents that will actually be making most payments (because payments are either too boring or too complicated for people to want to get involved) and remotely with other wallets. Why would my wallet want to communicate with another wallet? Well, to transfer central bank digital currency (CBDC) offline is a future use case, but even before then think about how payments, identity and credentials will need to work in practice: back again to that point of what the "ceremony" is that consumers will accept and expect?
- Here is a simple example. I run a store, and you come in to buy beer. How can I check that you are over 18 or 21 or 37 or whatever the limit is in our jurisdiction? Well, one way would be for your digital wallet to ask my digital wallet! Instead of having some special service, custom equipment, or expensive device to check my age, your digital wallet could simply ask my digital wallet (via Bluetooth, or NFC or even QR code) for the relevant credential. When I am asked if I am over 18, or have a drivers licence, or am a British citizen then I could see the digital wallet on my phone pop up with a list of credentials that a) will satisfy the criteria demanded and b) are acceptable to whoever is asking. I would expect my wallet to present the credentials to me in privacy-maximising order, so that for almost all such interactions my "John Doe" IS-OVER-21 credential will be the default to present not only to the clerk in the liquor store but actually the overwhelming majority of transactions.
- My point is that if you think that digital wallets are only about selecting payment cards to make online payments, I think you are seriously missing the big picture.

Afore Consulting's 7th Annual FinTech and Regulation Conference on 7 February 2023 from 9:00 am till 6:20 pm CET and on 8 February 2023 from 9:00 am till 6:25 pm CET.
- Please find below two different links for each day of the conference:
- 7 February - The morning session 9:00am - 1pm CET / The afternoon session 2:25pm - 6:20pm CET
- https://us06web.zoom.us/j/85623730570
- Webinar ID - 856 2373 0570
- 8 February - The morning session 9:00am - 1pm CET / The afternoon session 2:00pm - 6:25pm CET
- https://us06web.zoom.us/j/84439953357
- Webinar ID - 844 3995 3357

OMFIF DMI
- The OMFIF Asia forum | Hybrid, Singapore, 8 December; Leading policy-makers, governments, investors, financial institutions, fintechs and other thought-leaders gathered in Singapore to reflect on the challenges and opportunities this new era brings in Asia. They shared key insights in areas of global economics, investment, technology and financial markets. The DMI panel covered explored the future of money: tokenised deposits, stablecoins and CBDCs.

- Speakers:
  - Rana Kortam, Director, Global Public Policy, Binance
  - Naveen Mallela, Managing Director, Onyx Coin Systems, JP Morgan
  - Andrew McCormack, Centre Head, Singapore, Bank for International Settlements Innovation Hub
  - Sopnendu Mohanty, Chief Fintech Officer, Monetary Authority of Singapore
- Watch on demand here.

- Podcasts
  - Everything FTX - Sinan Yilmaz, account and content manager, OMFIF Digital Monetary Institute joins Lewis McLellan, Editor, OMFIF Digital Monetary Institute.
  - Find more DMI on demand content here.
- This month's must-read commentaries:
  - Remittances must go digital – Chad Harper, Senior Fellow, Visa Economic Empowerment Institute
  - Crypto and blockchain industries desperately need a win in 2023 – Lewis McLellan, Editor, OMFIF Digital Monetary Institute
  - Cryptocurrencies can improve speed, cost and ease of access of payments – Rana Kortam, Director of Global Public Policy, Binance
  - Find more DMI commentaries here.
- Our recent reports & launch panel discussions
  - In association with AWS, Binance, Bitt, Flutterwave, Payoneer, RTGS.global and Swift, our 'Future of payments 2022' report is available for download. The launch panel discussion is available to watch
  - For the virtual launch of OMFIF's annual 'Future of Payments' report, the panel discussed the frictions involved in cross-border payments and the role that innovative technologies have to play in removing them. As the metaverse takes shape and digital currencies gain in notoriety, the panel examines whether these have the potential to improve cross-border payments, particularly for emerging markets where unreliable fiat currencies often make new solutions more attractive.
  - Speakers:
    - Simon Chantry, Co-founder and Chief Information Officer, BITT
    - Robert Clarkson, Chief Revenue Officer (CRO), Payoneer
    - Sonja Davidovic, Adviser, Innovation Hub Bank for International Settlements
    - Saskia Devolder, Strategic Programme Director Cross-border Payments, SWIFT
    - Chad Harper, Senior Fellow, Visa Economic Empowerment Institute
  - Watch on demand here.
- Curated content for you – latest from the digital economy
- News and press releases
  - Dubai International Financial Centre launches new metaverse platform in line with the Dubai Higher Committee for Future Technology and Digital Economy's goals. Read more.
  - The International Swaps and Derivatives Association has released new definitions for Digital Asset Derivatives this month covering Bitcoin, Ether, and

other digital assets and tokenised assets executed on distributed ledger technology, as well as automated smart contracts. Read more.
    - In the USA, the Digital Dollar Project have also released a new white paper analysing ongoing CBDC projects in 114 countries, and revisits seminal concepts first proposed in the Digital Dollar Project's inaugural white paper. Read more.
    - In China, the E-CNY CBDC now allows mobile payment transactions without internet and with 0% battery for users of android mobile device. This was a design goal the People's Bank of China has been aiming for since 2020. Read more.
    - As of 2023, the National Payments Corporation India has also expanded to include ten new jurisdictions namely: Singapore, Australia, Canada, Hong Kong, Oman, Qatar, US, Saudi Arabia, United Arab Emirates, and the United Kingdom. Read more.
- Public sector publications
    - 'Central bank digital currencies: Lords Economic Affairs Committee report' – UK House of Lords; The UK House of Lords are due to debate CBDCs on 02 February, on the findings of this report which explores perspectives from the Bank of England, as well as the wider calls for caution from stakeholders who suggest that CBDC implementation in the UK may need further review. Read more.
    - 'Press Release on the Use of Digital Turkish Lira' - Central Bank of the Republic of Türkiye In Turkey, the Digital Turkish Lira Project, carried out a successful test transaction with more development on the horizon for 2023. Read more.
    - 'The Economics of a Central Bank Digital Currency in Australia' – Reserve Bank of Australia; Brad Jones, Assistant Governor (Financial System), Reserve Bank Australia made an insightful speech regarding the strategy considerations being made regarding CBDC development in Australia. Read more.
    - 'The Technology of Decentralized Finance (DeFi)' – Banks for International Settlements; The Bank for International Settlements releases a working paper which seeks to provide a comprehensive overview and classification of DeFi. Read more.

BIS: Holistic regulations needed for Big Tech in finance Bank for International Settlements General Manager Agustin Carstens says regulators need to rethink how they set rules for Big Tech companies that provide financial services, citing their massive size and influence over e-commerce and social media. Carstens has called for a new "holistic" global rule framework. "Without a doubt, a regulatory rethink is warranted, and we need a new path to follow," Carstens said. Reuters Global Investor

CFTC: Cyber rules needed to prevent future system hacks US CFTC Chair Rostin Behnam said in a speech that the cyberattack on ION Trading UK illustrates the need for new cybersecurity regulations "to preserve the integrity, availability, and confidentiality of critical systems and information." Behnam said that "the industry's necessary and increasing reliance on third-party service providers creates a major source of risk for participants in our markets, a risk that is only promised to rise with growth of virtual access and cloud-computing." BNN Bloomberg (2/3), The Block

GOOGLE: Google announces ChatGPT rival Bard, with wider availability in "coming weeks"; Alphabet Inc.'s Google is getting its ChatGPT competitor ready for prime time. The company said on Monday that its new conversational AI service, called Bard, would be opening up to trusted testers, and that it is readying the service for the public "in the coming weeks." The technology aims to generate detailed answers when given simple prompts, such as what to make for lunch or how to plan a friend's baby shower. /jlne.ws/3lk3OiM

GOOGLE : (-7.68%) On Wednesday, Google held a highly anticipated press conference from Paris that did not deliver the decisive move against ChatGPT and the Microsoft-OpenAI partnership that many pundits expected. Instead, Google ran through a collection of previously announced technologies in a low-key presentation that included losing a demonstration phone. The demo, which included references to many products that are still unavailable, occurred just hours after someone noticed that Google's advertisement for its newly announced Bard large language model contained an error about the James Webb Space Telescope. After Reuters reported the error, Forbes noticed that Google's stock price was getting clobbered.. (arstechnica.com)

- "I just saw a few clips of the Google event in Paris. And i now for the first time have some doubts about Google. Just rookie presentation mistakes ("we can't find the phone") scream "last minute rush". That happens, it's just unfortunate it was now. Also the factual error..." (@dimensionmediaDad³. PHP/WordPress/BuddyPress. Project Manager)

MICROSOFT: Satya Nadella (CEO): "This new Bing will make Google come out and dance, and I want people to know that we made them dance." #!! #Dance!

After SingularityNET, Fetch.AI & Graph, now Near Protocol's (NEAR) price pumps *over 15%* on news of AI-based Dapps on the blockchain. Artificial Intelligence Focused Cryptocurrencies Are Vastly Outperforming Bitcoin. Tokens utilizing AI technology have been on a tear in the past months. Some are sold on the hype, while some remain wary. #Cryptocurrencies are pivoting to AI (Coindesk)

Stablecoins' ability to defend USD parity questioned Since the collapse of the terraUSD stablecoin in May, eight experts have expressed varying concerns that other issuers may not be able to maintain their peg to the US dollar. Barclays fixed income strategist Joseph Abate says the risks are limited to the crypto sector and don't pose "a systemic risk." Risk

Institutional Traders Shifting Attention from Blockchain to AI: JP Morgan; More than half of the institutional traders surveyed by global financial services giant JP Morgan said that artificial intelligence and machine learning will be the most influential technology in shaping the future of trading over the next three years-cited four times more often than blockchain and distributed ledger technology. /jlne.ws/3wZtnbB

Global Crypto Industry Pledges Aid to Turkey Following Deadly Earthquakes; Local and foreign crypto exchanges have pledged aid to Turkey after two powerful earthquakes and multiple aftershocks claimed thousands of lives on Monday. The earthquakes have so far claimed at least 2,100 lives in Turkey and Syria, with organizations and countries around the world offering support as rescue efforts are underway. The international crypto community has shown an

eagerness to send donations via digital assets, with multiple platforms pledging support. /jlne.ws/3X9f8vA

Britcoin? UK gets closer to launching a digital currency; *In particular, the platform model proposed for the UK provides the basis for a diverse, competitive, and open market of service providers, which will stimulate further innovation and attract investment in the UK.*

- The Bank of England and the Treasury have today published, as a Consultation Paper, their assessment of the case for a retail central bank digital currency (CBDC) – a so-called 'digital pound'.
- Digital Pound is moving closer to reality. U.K. authorities on Monday said British businesses and consumers are likely to need a digital version of the pound, formally asking for public comment on the idea of introducing a central bank digital currency.

Bank of England and HM Treasury

Bank of England | HM Treasury

The digital pound: a new form of money for households and businesses?

Consultation Paper
February 2023

Bank of England — The digital pound: features of the digital pound

Digital pounds would be stored directly at the Bank of England, but users would access these through digital wallets offered by private companies.

Central bank core ledger
Fast, secure, and resilient platform providing payments functionality.

API layer
Allows regulated intermediaries to connect to the core ledger.

Intermediaries
Firms providing user-friendly wallet interfaces and/or value-added services.

Users
Register with intermediaries to access the digital pound.

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- It has been overseen by the joint Bank-HM Treasury CBDC Taskforce that was announced in April 2021.
- *"At this stage, we judge it likely that the digital pound will be needed in the future. It is too early to decide whether to introduce the digital pound, but we are convinced preparatory work is justified."*
- What would a digital pound look like?
  - The digital pound would be a new form of sterling, similar to a digital banknote, issued by the Bank of England. As such, it will have intrinsic value and not be volatile, unlike unbacked cryptoassets.
  - It would be used by households and businesses for their everyday payments needs. It would be used in-store, online and to make payments to family and

  friends. If introduced, it would exist alongside, and be easily exchangeable with, cash and bank deposits.
  - The digital pound would maintain public access to retail central bank money and, as our lifestyles & the economy become ever more digital, it would also promote innovation, choice & efficiency in domestic payments.
- How might a digital pound work?
  - Platform Model: The BoE would provide the central public infrastructure in the form of a core ledger. The core ledger would provide the minimum necessary functionality for CBDC, & must meet the BoE's performance, resilience & privacy requirements, while maintaining consistency at all times.
  - Functionalities: The digital pound could offer an array of functionality & features, including payments, payment devices, wallet management, economic design, interoperability, identity, and data. The payments use cases for CBDC are likely to evolve over time.
  - Data Protection & Privacy: To support trust and confidence, the digital pound would be subject to rigorous standards of privacy & data protection.
  - Programmability & User Experience: The BoE would aim to support programmable functionality and use cases which are designed to give users greater functionality from their wallets & CBDC holdings.
  - Holding Limit: a UK CBDC would be subject to some limits on individuals' holdings, at least during its introductory period. The technology design should support the implementation of these limits, including, if needed, the ability to change either the design or the level of any limit.
  - Unremunerated.: The BoE's vision for the digital pound is similar to that of a digital banknote. This means it would not pay (nor charge) an interest rate.
- During this consultation, HM Treasury and the Bank of England will engage extensively with stakeholders across the UK to seek views on the proposed model of the digital pound set out. Responses to this consultation, which closes on 7 June 2023, are invited from all interested members of the public, experts, & organisations.
- A Central Bank Digital Currency, together with UK plans for regulated stablecoins and recognition of smart contracts under UK common law, can stimulate a new wave of innovation in payments, with the potential to further increase productivity across the economy, offer citizens new services, revolutionise other consumer sectors, and widen access to digital finance.
- UK to Start Further Development Work on 'Likely Needed' Digital Pound; The Bank of England is starting further research and development work on a digital pound for purchasing goods and services - something that's likely to be needed in the future, the regulator said Monday. The central bank and the country's finance ministry wants the public to weigh in on its plans for a digital version of the pound sterling, and will publish a consultation open to public comment on Tuesday. /jlne.ws/3lixjSp
- Jon Cunliffe says it is likely that a retail, general purpose digital central bank currency - a digital pound – will be needed by the end of this decade. He discusses why this is the case, what the model could look like and how the digital pound may sit within the digital payments landscape. https://b-o-e.uk/3DNRzBy
- Britain, home to the world's second-biggest financial center, is trailing former colonies such as Nigeria, the Bahamas and Jamaica in rolling out a digital currency. /jlne.ws/3YMhUs3

The way we use money in the United Kingdom is changing, bringing fresh opportunities and new considerations for public policy. Banknotes, issued by the Bank of England, are being used less frequently by households and businesses. *New technologies are allowing for the emergence of new forms of digital money, and new ways and devices to pay with it. International developments have the potential to affect the UK domestically and as a global leader in finance.*

- Ensuring that public trust in money remains high, and that our modern forms of money and payments meet the evolving needs of individuals and businesses, are fundamental responsibilities of the Government and the Bank of England. We are determined that the UK should remain at the forefront of innovation in money, payments, and financial services. This is part of the Government's vision for a technologically advanced, sustainable, and open financial services sector that is globally competitive and acts in the interests of communities and citizens, creating jobs, supporting businesses, and powering growth across all four nations of the UK.
- A UK central bank digital currency – a 'digital pound' – would be a new form of digital money for use by households and businesses for their everyday payments needs. As part of the wider landscape of money and payments it would sit alongside, not replace, cash – a digital counterpart to familiar, trusted banknotes and coins, subject to rigorous standards of privacy and data protection. A digital pound would help to ensure that central bank money remains available and useful in an ever more digital economy, continuing to bolster UK monetary and financial stability while safeguarding the UK's monetary sovereignty in a changing global financial system. It could provide a platform for private sector innovation, promoting further choice, competition, efficiency, and innovation in payments. It could also have further benefits for the resilience and functionality of payments in the UK.
- On the basis of our work to date, the Bank of England, and HM Treasury judge that it is likely a digital pound will be needed in the future. It is too early to commit to build the infrastructure for one, but we are convinced that further preparatory work is justified. Any future digital pound would be a major piece of national infrastructure which would likely take several years to complete. Its launch would require deep public trust in this new form of money – trust that their money would remain safe, accessible, and private. The journey towards issuing any digital pound therefore necessarily involves an open, national conversation about the future of our money, in parallel with detailed technical consideration by experts across the UK public authorities and informed by evolving market trends.
- This consultation – issued jointly by HM Treasury and the Bank of England – opens that conversation and seeks to begin to build that foundation of public trust. It seeks feedback on the policy and technical work undertaken so far in order to inform a future decision on whether or not to progress building and launching a digital pound and on our current proposal for its form and functions which will be taken forward in the next stage. It commits us to progressing the next stage of technical and policy work needed to underpin such a decision. This paper is being issued alongside a Technology Working Paper from the Bank of England, exploring the many technology challenges involved in a digital pound. In the coming four-month consultation period, HM Treasury and the Bank of England will engage extensively across the UK to seek views on a potential digital pound. Responses to the consultation are invited from all interested members of the public, experts, and the widest range of organisations.

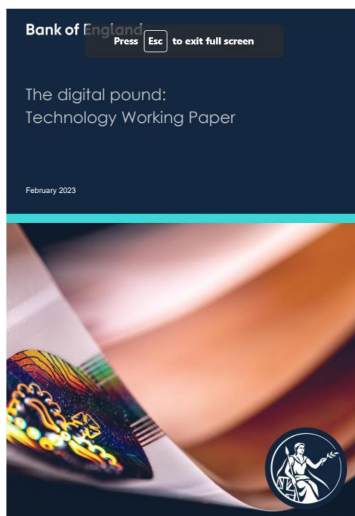
- At this exciting time of change in money and payments, this consultation is a vital step in positioning the UK to act decisively by introducing a digital pound, should we choose to do so.
    - *Rt Hon Jeremy Hunt MP, Chancellor of the Exchequer*
    - *Andrew Bailey, Governor of the Bank of England*

ESMA updates Q&As on the implementation of Regulation (EU) 2022/858 on a pilot regime for market infrastructures based on DLT; *On 3 February 2023, Authority updated its Questions and Answers (**Q&As**) on the implementation of Regulation (EU) 2022/858 on a pilot regime for market infrastructures based on distributed ledger technology (**DLT**). The Q&As have been updated to include the following topics:*

- Reporting of natural persons.
- Issuer for DLT financial instruments that are the digital representation of a previously issues financial instrument.
- Issuer for DLT financial instruments that are directly issued using a DLT.
- Instrument ID for transparency publication.

Digital Pound: CBDC Technology; *Alongside the Consultation Paper released today, the Bank of England also published a Technology Working Paper outlining emerging thinking on CBDC technology. This technology working paper:*

- outlines the Bank of England's emerging thinking on CBDC technology.
- explores technology design considerations which help to form a basis for the Bank's current thinking on the technology requirements of a UK CBDC, and which will likely have significant impact on the design choices for CBDC.
- sets out an illustrative conceptual model, which is based on the platform model of CBDC.
- outlines how different components of the conceptual model might operate and how ecosystem participants might interact with these components.
- The Bank explores six technology design considerations which can help organise and guide its technology work. They will likely have significant impact on eventual CBDC design choices. While there are other technology considerations to be taken into account, the Bank considers that these six considerations are priorities and will provide a basis for testing architectures and solutions and evaluating design trade-offs. These design considerations are:
    - Privacy
    - Security
    - Resilience
    - Performance
    - Extensibility
    - Energy usage
- The Bank is seeking feedback on the questions set out in this paper. This feedback will help to inform its future technology work. The Bank invites responses to this paper from stakeholders and technology experts until 7 June 2023.



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On 7 January 2023, HM Treasury and the Bank of England (BoE) published a joint Consultation Paper on the digital pound: a new form of money for households and businesses?

- In this consultation HM Treasury and the BoE are consulting on a proposal for a retail UK central bank digital currency (**CBDC**). A UK CBDC – or 'digital pound' – would be a new form of digital money for use by households and businesses for their everyday payment needs. As part of the wider landscape of money and payments it would sit alongside, not replace, cash, as a digital counterpart to familiar, trusted bank notes and coins. Unlike cryptoassets and stablecoins, the digital pound would be issued by the BoE and not the private sector.
- The BoE and HM Treasury judge that it is likely a digital pound will be needed in the future and that, whilst it is too early to commit to building the infrastructure, further preparatory work is justified. They note that the case for introducing the digital pound will depend to a significant degree on how the payments landscape evolves in the coming years.
- The consultation seeks feedback on the policy and technical work undertaken so far, in order to inform a future decision on whether or not to progress building and launching a digital pound, as well as on the current proposals for its form and functions.
- The consultation does not cover a wholesale CBDC, which would be used to settle high-value payments between financial firms. The concept of a wholesale CBDC is discussed in a box in Part D of the consultation, alongside the BoE's work with industry to enhance wholesale payments through Real-time Gross Settlement (**RTGS**) renewal and the RTGS future roadmap.
- Proposals
- The consultation proposes the following:
  - If introduced, the digital pound would replicate the role of cash in a digital world, so that it is risk-free, highly trusted, and accessible.
  - £10 of a digital pound would always be worth the same as £10 in cash.
  - The digital pound would be accessed through digital wallets offered to consumers by the private sector through smartphones or smartcards.
  - The BoE would provide the central public infrastructure in the form of a 'core ledger' – a fast, resilient, and highly secure technology platform, which would

provide the minimum necessary functionality for the digital pound. Regulated private firms could then access this infrastructure, design innovative services using the digital pound, and handle all user-facing interactions.
    - A digital pound would be subject to rigorous standards of privacy and data protection. Like current digital payments and bank accounts, the digital pound would not be anonymous because the ability to identify and verify users is necessary to prevent financial crime.
- A limit on individuals' holdings would apply at least in the introductory phase. This would strike a balance between both encouraging use and managing risks, such as the potential for large and rapid outflows from banking deposits into digital pounds. These limits could be amended in the future.
- Next steps: The deadline for comments to the consultation is 7 June 2023. Work will now move onto a 'design phase' which will look at the technology and policy requirements for a digital pound, to ensure that its development can be accelerated if a decision is taken to build it.
- Responses to the consultation will inform the next stage of work and constitute an important step towards making a final decision on whether to build a digital pound.

1. De-dollarization is assisted suicide

- The Decline of the Dollar, Suicide with Assistance. Including help from Nordstream?
- "Can the slow decrease of the USD position, including through the use of crypto assets [cbdc], benefit EU companies threatened by the US secondary economic sanctions?"
- The assumption of EU-US marching in perpetual lockstep is flawed. Today's astounding accusations from Pulitzer-winner Seymour Hersh that the US blew up the NordStream pipeline make questioning that assumption essential!
- "The de-dollarization of the world, as a reserve currency, is a recurring issue that, sooner or later, will prove the point of the economic doomsayers.
- The authors rightly focus on sanctions:
    - "The threat [of dedollarization] might come from the money itself which, through out-of-control economic sanctions policy and crypto-assets development by State actors, might have launched a slow suicide with assistance."
    - "US sanctions have risen by 933% between 2000 and 2021 before the RU invasion."
    - "This out-of-control sanctions policy led to a massive bulk, turned economically viable, of sanctioned entities."

Sanctions, Crypto and CBDC; *I agree that sanctions are behind de-dollarization and that sanction "impacted" nations now are a "viable bulk." BRICS and RCEP nations developing CBDCs show that it isn't just sanctioned nations pushing de-dollarization but all those impacted.*

- I disagree that crypto can play a significant role. Crypto use in Ukraine, Iran, and Russia shows that volumes are too small to save any of them or impact the USD. The US arrest of a crypto exchange head for Russia money laundering also shows the US is watching. It also shows just how "pseudo" pseudonymous is in crypto, where transfers can be tracked if the government wants to.
- The authors are correct that CBDC is a game changer, and I expect the BRICS CBDCs to come into play this year or next. They are game changers.
- Still, will the digital euro benefit EU companies? Not now, but it is certainly insurance for the future.

- I am sure many readers will still say, "it can't happen, the EU and US are joined at the hip." It already has. The EU defied Trump by using INSTEX transfers, not SWIFT, to send humanitarian pandemic aid to Iran in 2020.
- Clearly, EU and US interests can diverge. Never take that for granted. Nordstream may be proof.
- Takeaways:
  - De-dollarization is very much a self-inflicted wound but is short of suicide.
  - Disaffected sanction "impacted" nations have "economically viable bulk" they will not tolerate being ignored.
  - Crypto will play a minor role in de-dollarization; liquidity is still far too low.
  - CBDC is the game-changer for the USD; watch carefully!
  - The digital euro is the EU's insurance policy.

2. Bank deposit tokens are coming; Bank Issued DEPOSIT TOKENS, as blockchain comes to banking and payments! - Oliver Wyman and Onyx by JPMorgan on how banks will use blockchain to tokenize deposits, a great idea with a few caveats!

- What are they? "Deposit tokens (DTs) refer to transferable tokens issued on a blockchain by a licensed depository institution which evidence a deposit claim against the issuer."
- DTs offer banks a way of digitizing payments that provides them with easier integration into their existing systems than CBDC or stablecoins.
- Let's look at how they fit in our trilogy of fiat digital payments, in order of risk from low to high:
- 1 CBDCs:
- With CBDC we have essentially zero risk as we're dealing with gov't backed money, this makes them the lowest risk of the three options to hold.
- 2 Blockchain-based DTs:
- Here we have licensed banks with full liquidity, risk management and other cash management systems. This puts their risk as higher than CBDCs but lower than the stablecoins— that we have now.
- 3 Stablecoins:
- Unsurprisingly the report shows no love for stablecoins. Banks hate them!
- The report argues that, for myriad reasons, they represent a greater risk than DTs. I would have to agree as stablecoins stand today. The problem is that if stablecoins are regulated as "narrow banks," as the US may propose, the risk gap will narrow.
- So, what are the CAVEATS? - Banks won't stop with wholesale payments and will attempt to push DTs out on the retail market. For retail use, I believe that DTs represent an inferior solution to CBDCs and Stablecoins as they maintain banks' lock on your money.
- Both stablecoins and CBDCs give users greater control of their money. If we learned anything from crypto, it's that most want to take back control from banks.
- DTs also open the door for banks to collect fees at will, and it will likely be impossible for smaller banks to provide this technically sophisticated service.
- Can you imagine big banks using DTs to cut out smaller institutions? I can. That is why I support national CBDCs where payment is a "public good" available to all! I like DTs, I think that they solve real problems for banks and that banks should press on with their development.
- Programmability, blockchain, atomic transfer, and easier integration into bank systems make DTs a winner!
- Takeaways:

    - Deposit tokens are GREAT wholesale transfer technology!
    - They give banks a way to join in the digital currency revolution and give blockchain a major boost.
    - The problem is that when used in retail payments won't give you greater payment autonomy.
    - Unlike retail CBDCs, they do nothing for inclusion.

3.: Britcoin explained: the Digital Pound is a design masterpiece! - *"Britcoin," the official moniker for the "digital pound" central bank digital currency (CBDC), is coming!*

4. Lack of digital trust is killing innovation; *Don't blame digital innovation for snowballing societal distrust!*

- The ITIF makes the blockbuster claim that growing societal distrust is driving digital trust to new lows, not the other way around, and that distrust is hindering innovation.
- This is one of the more insightful papers I've read in a while. Let's face it between the Twitter files, data hacks, crypto crashes, and fake news, our digital world has a long way to go in the trust department.
- The ITIF, however, flips the digital trust debate and makes a compelling argument. How do we rate the impact of digital events on trust when we compare them to broader societal distrust generated by a recent long laundry list of horrors? False claims of WMDs, paedophile scandals, OxyContin scandals, Afghanistan, and $31 TN in gov't debt?
- Chicken or the egg? - This is a "Which came first, the chicken or the egg?" problem. The ITIF makes the case that societal distrust caused by an "erosion of institutional trust" created much greater distrust than anything from the digital world. Sadly, I think that the ITIF is right. I see it daily with CBDCs, where many who distrust CBDCs rely on arguments that rely less on digital tech than the fear of the institutions issuing them. This distrust is slowing necessary innovation. Still, the ITIF, funded by big tech, did a poor job of acknowledging that digital essentially pours gasoline on the existing fire of social trust, forcing it to burn hotter and faster.
- Declining trust hinders innovation; The ITIF makes the case that declining societal trust will limit the US's ability to innovate in digital technologies. I think they're right, as I show with CBDCs.
- In China, I personally see how the population's trust and enthusiasm for new digital products are greater than in the US. While "enthusiasm" is hard to quantify, one example is that Chinese mobile phone users lead the world in the number of apps on their phones. This is even more surprising given that China has super apps, and many individual apps aren't needed!
- WeChat and Alipay succeeded not just because they solved payment problems but because they launched into a trusting and eager population. I don't see that eagerness in the US and EU, where digital advances are looked at suspiciously.
- "The problem is that the US's declining national trust presents a direct challenge to its future technology leadership."
- The ITIF is right. Innovation requires not just innovators but people who trust using the innovation! As long as trust remains low, innovation will suffer. This will be a major drag on American innovation for years to come.
- Takeaways:
    - We blame digital for many societal problems, but digital just mirrors society.
    - The distrust of digital tech hinders innovation.

- Digital amplifies existing societal problems.
- All is not lost! ChatGPT just became the world's fastest-growing consumer app!
- Ironically, ChatGPT's answers are not trusted!

EU to set third-party tech vendor rules to curb risks The EU plans to launch a consultation this summer on draft regulatory technical standards that will cover contractual arrangements with third-party technology vendors as part of the Digital Operational Resilience Act. The move follows the cyberattack on Ion, and the new standards will "take into account the size, nature, scale, complexity and overall risk profile of the financial entities." Futures & Options World

The rise of paytech's lucky 7; *Seven forces shaping the rise of PayTech - Payments face a nuclear-sized disruption, and EY values the PayTech sector at $2.2tn! Never forget why we need PayTech! The US and EU are paying 2.3% and 1.4% of their total GDP in payment costs! We desperately need modernization. EY does a great job, but as usual, I disagree in a few places:*

- 1 Open Banking; "It's about time!" Most of us are locked into our banks, and open banking is a game changer by giving us control of our data. The process is going slow because banks prefer having you locked in! That's why we need RTP.
- 2 Real-time Payments (RTP); EY sees RTP following open banking, I disagree and see it driving open banking. RTP is the key tech that will bust open bank monopolies. How we get it done is immaterial, but we need it yesterday. Why? Currently, payments are a DRAG on GDP, while RTP brought an additional 1.12% to GDP in the UK and Thailand! (Same in China.)
- 3 Cross-border Payments; Clearly, this is where CBDCs shine, but other RTP networks can also achieve lower costs, as seen in ASEAN. We can and should hard-wire networks together for now, but only CBDCs are going to provide that futuristic global solution we deserve.
- 4 BNPL; I'm not a big fan of BNPL, and the collapse of BNPL provider OpenAI in Australia today in a deteriorating credit market is significant. Compared to big data-based loans like Alipay's, BNPL seems not just low-tech, but a scam designed to trick people into missing payments.
- 5 Digital Wallets and Super Apps; I love them both, but you aren't going to get anything super without RTP. Sure, card "pass-through" wallets, like Apple or Google, are great, but card fees mean they aren't ever going to be "super."
- 6 Embedded Payments; So the best the West can do is embed a BNPL provider into e-commerce? BUNK! CBDCs will bring universal embedded payments based on national digital payment networks. Payments will simply be everywhere as it is in China now with WeChat, Alipay, and soon e-CNY.
- 7 CBDCs; I love them and think that they are the ultimate manifestation of PayTech. They will also disrupt many of the business models for PayTech companies. If your PayTech depends on squeezing margins, there's nothing to squeeze when payments are free.
- Takeaways:
  - PayTech is a game changer, but we haven't seen anything yet!
  - Free national CBDC networks are the ultimate PayTech.
  - RTP, like Fed Now or SEPA, is the first step and will force banks to change.
  - BNPL is low-tech and, with big data underwriting around the corner, is set for a fall.

The digital pound – speech by BoE's Jon Cunliffe; *On 7 February 2023, the Bank of England (**BoE**) published a speech by Sir Jon Cunliffe (Deputy Governor, Financial Stability), given at UK Finance, on the digital pound. The speech begins by setting out the headline conclusions from the recent report from the BoE – HM Treasury Taskforce on the introduction in the UK of a central bank digital currency:*

- On current trends, it is likely that a retail, general purpose digital central bank currency – a digital pound – will be needed in the UK.
- We are not yet at a point where a firm decision can be made to implement a digital pound.
- Given the likely need for the digital pound and the lead time to introduce it, the BoE and HM Treasury will now proceed to the next stage of detailed policy and technical development – including the development of a technical blueprint. This stage will take around two to three years following which a decision will be made whether or not to proceed to the next stage and implement a digital pound in the UK.
- The digital pound would not be the same as a cryptoasset – it would be a safe, trusted form of money accepted for everyday transactions by households and firms.
- The speech goes on to state that:
    - The Taskforce's view that a digital pound is likely to be needed is grounded in the view that a further decline in cash use and further development in the digitisation of money and payments is likely. Also, these developments raise important questions to which the BoE and the Government should respond.
    - The BoE has made it clear that cash will remain available to any and all that want to use it and the Government is taking powers under the Financial Services and Markets Bill to give the BoE and the FCA new powers to ensure the future effectiveness, resilience, and sustainability of the cash ecosystem.
    - If designed appropriately, a digital pound could complement and support new forms of private digital money and payment services, for example by acting as the 'bridging asset' between different platforms enabling convertibility. By establishing technical standards available to all, it could help ensure interoperability between different platforms. The Taskforce's assessment is that a digital pound, as an alternative, publicly issued form of digital money, available to all, would help ensure competition and innovation and drive efficiency in payments.

Europe Needs an Alternative; It's time to think about a post-card European alternative payment scheme. Could it be SPAA? – David Birch

- Patrizia Flammini runs a cafe in the centre of Rome. According to the Financial Times, her heart sinks when a customer pays for a coffee with a payment card (as I always do, everywhere, all the time). Why? She says that the cost of accepting cards is so high that the bank earns more on a cup of coffee than she does.
- If You Don't Like Cash, Don't Take It
- When I read this, I naturally thought to myself "so what?" and "if she doesn't like cards, she shouldn't take them" because as far as I am concerned, retailers should be able to take whatever they want in payments. If they want to take cash or cowrie shells, cards, or chocolate (cocoa was a currency in South America for hundreds of years) then it should be up to them.
- In some illiberal places, however, that is not true. In some places shopkeepers are forced to accept certain payment instruments. In El Salvador, for example, retailers are forced

to accept Bitcoin. In New York, retailers are forced to accept cash. In Italy, retailers are forced to accept cards.

- What? Yes. Cash payments are not banned, but Italian retailers have to accept electronic transactions or face a fine of €30 and 4% of the transaction value. This law was introduced as part of Italy's post-Covid national recovery plan as an attempt to reduce tax evasion. The retailer can choose which electronic means they accept: They do not have to accept bank cards; they could accept payments apps or digital wallets or whatever. But they must accept at least one electronic payment option and for almost all of them, that means cards.
- Shopkeepers such as Patrizia were hoping to have the option to refuse cards for cups of coffee and suchlike though. The new prime minister, Ms. Giorgia Meloni, wanted to give them the right to refuse electronic payments for transactions under €60 while simultaneously raising the limit for legal cash transactions from €1,000 to €5,000.
- (I was interested to see the president of the Lego Nord, the economist Claudio Borghi Aquilini, defend the use of raising of the limit for cash transactions to €5,000 using what seemed to me to be the remarkably Italian argument that if he wants to buy a necklace for his mistress "what can I do with the limit of one thousand euros? I take the car, go to Lugano, and pay cash.")
- Unfortunately for Patrizia the Economy Minister Giancarlo Giorgetti announced a U-turn in December the plan to allow merchants to refuse payment by card for smaller amounts was scrapped, although the arguments about it will undoubtedly continue.
- Cash Fans
- What is going on? Well, in Italy the number of non-cash transactions per capita increased by 24 % in 2021, driven mainly by card transactions, but even with this increase, it must be noted that according to official figures, Italy remains bottom of the Euro table in terms of non-cash transactions per capita: 130 transactions per inhabitant in 2020 compared with 297 on average in the euro area.
- The use of cash varies pretty widely across the regions. Central bank analysis based on international comparisons and Italian data at province level show that differences in per capita income and in the degree of technological innovation play a central role in explaining the gaps. Cash is most widely used in central and south Italy, by women, young people, and those with the lowest incomes; students; the unemployed and, crucially (as we will see) the self-employed also tend to use cash more intensively.
- (By contrast, people with higher levels of education, more income, the employed and rather interestingly pensioners make greater use of non-cash payments.)

- Why would the new Italian government want to increase the use of cash? Is it an issue of national resilience, as hinted at in the recent story from The Times concerning the sorry tale of a PR consultant and her family who were on holiday in Cinque Terre, Italy, when a storm cut off the power in the town for 24 hours. This took down the POS terminals and ATMs so unlike the fortunate Ms. De Franco, who had cash on her, many people were stuck. She says of the ordeal, "My husband sometimes doesn't even take a wallet because he pays on his phone".
- Begging the question of way retailers couldn't take contactless payments using their mobile phones or take card details for later manual entry or take IOUs from people that they knew in the town, or whatever, I doubt that disaster planning has much to do with Ms. Meloni's plans which, of course, to do with politics and not economics.
- Small Starts
- Ms. Meloni says that "cash must be king" and told the Italian parliament that "the only legal currency in Italy and Europe is the paper notes issued by the European Central Bank" and that electronic money is not legal tender (which is true everywhere but, as we all know, does not matter) and it is a form of private money.
- Indeed, it is. But so, what? Well, Ms. Meloni's policy is aimed at her small business supporters who object to the commissions on card payments, agree with her that merchant services charges are an "illegitimate present to the banks and financial firms that sell these services" and, I don't doubt, agree with her view that financiers in general and George Soros in particular are the shadow puppet masters of the deep state and manipulate the political system to enrich themselves.
- (Frankly, whenever I see that kind of focus on George Soros, I naturally hear the antisemitism alarm bells ringing, but that is another issue.)
- Lorenzo Codogno, a financial analyst (and former official at the Italian treasury) reinforced my suspicion about the underlying reason for the dash to cash, saying that "I suspect this is also linked to pressure from retailers who prefer cash because it gives them the flexibility to avoid tax", a view supported by political consultant Wolfango Piccoli, who said that the new right-wing government is listening to "groups like taxi drivers, who you can never ignore in Italy — this is a good budget for tax dodgers".
- (There is good evidence to support this view, by the way. Six years ago, electronic payments became mandatory in the hotel and catering industry. As a result, declared revenues from those businesses rose considerably, along with their tax contributions.)
- This why, as you might imagine, the plan has seen some pushback from the central bank precisely because of concerns about the black economy and the scale of tax evasion in the country. Italians evade around €100 billion in tax every year, which is around double the rate of tax evasion in northern Europe. For comparison, in Britain the "tax gap" is more than £30 billion and around half of this is down to sole traders and small businesses not declaring cash income.
- Cash Costs
- I spent a day in London this week. I had no cash and no need for any. I bought my train tickets on my phone, used a contactless wearable (a ring) for the bus and the subway and coffee, paid for lunch with Apple Pay and bought drinks the same way. When I stopped in at Orc's Nest to buy some sundry Dungeons and Dragons items, I again paid with Apple Pay, as did the person in front of me.

- The restaurant that I went to does not accept cash at all, which is becoming normal in London. As an American Banker piece on the topic pointed out, restaurants give three main reasons for this:
  - At the La La Land Kind Café in Dallas the main reason was for sanitary purposes. The owner said "I'm a bit of a germaphobe, and cash is a very dirty thing. I wanted to keep it away from where we prepare food and drinks".
  - At the Skyrocket Burger a couple of miles away the main reason refusing cash was crime. The restaurant had had two break-ins when the register was stolen.
  - At the nearby Serious Pizza an important reason for the move away from cash was to move the line quicker. I assume this adds a fair bit to the taking. I can remember talking to a pub owner in the early days of ceaselessness in the U.K. and he told me that when potential customers see a line, they just walk past.
- As far as I am concerned, they can take what they like in payment. But that's not true in some places I mentioned. New York, for example, where the city has imposed a stealth tax on merchants and forced them to accept cash.
- Why, you might wonder. Well, Vilda Very Mayuga, the commissioner of New York City's Department of Consumer and Worker Protection, says that "It's not for the business to decide who they want to serve". Presumably they have to serve people with no shirt or shoes as well. But does this mean that the Department of Consumer and Worker Protection will be prosecuting the cash-only cafe in NYC that discriminated against me when I was last there because I only had cards? Will the Department of Consumer and Worker Protection be paying the $3.50 it costs cash-free people to get cash out of an ATM in order to buy things in a cash-only store? Will the Department of Consumer and Worker Protection be paying the extra costs incurred by the ice cream van that now has to install a cash draw and go to the bank to deposit the cash? Will the Department of Consumer and Worker Protection pay the extra insurance that merchants have to pay for holding cash on the premises?
- There are other jurisdictions beyond New York and El Salvador looking at imposing compulsory tender laws. Even the Norwegian government is planning a proposal to force businesses in Norway (where many see cash as useless, with some businesses already refusing to take it, and most people haven't even seen cash for years) to accept cash payments.
- Should we really be imposing a stealth tax on merchants by forcing them to accept cash any more than we should be forcing them to accept Bitcoin or, for that matter, cards? Should we be forcing banks to keep open branches to accept cash and install ATMs everywhere to dispense it?
- The answer is, as I wrote in the London Times this weekend, no. People seem to think that cash is free, but it really isn't. The cost to merchants is significant (which is why an increasing number of them don't take it) and the cost to society should not be overlooked.
- The APPian way; I suspect, then, that the merchants' dislike of card payments has as much to do with tax avoidance as it does with merchant service charges. Nevertheless, these Italian merchants have a point. They need an alternative. But what should that alternative be? Risk expert Wolfgang Piccoli was quoted in that context saying that "Europe is well aware that Amex, Mastercard and Visa are all American. It doesn't have a credit card company and that's a problem".

- Cards? Really? P- That isn't the problem. We don't need another credit card company and it is a fact that Europe has failed to develop an alternative to Visa and Mastercard many times. There are a number of reasons for this, but one obvious one is that Visa and Mastercard work very well indeed. Even using new technology such as biometrics or blockchains or whatever it would be something of a mountain to climb to try to create a card payment scheme to compete with them.
- No, the problem isn't that Europe doesn't have an alternative card scheme. The problem is that Europe doesn't have an alternative to cards, which is why "Le Third Scheme" should be based on the things that Europe does have: Open banking, instant credit transfer, smartphones, and payment institutions.
- (With this in mind, I was pleased to see that the European Payment Initiative, the EPI, abandoned its plans for a card scheme — which I always thought sub-optimal — and decided to focus an account-to-account instant payment solution (A2A) for all kinds of use cases, all through a wallet. There is an interesting synergy here with the European moves to develop a common digital identity service and euro-wallet infrastructure, but that's topic for another discussion.)
- These technologies and the regulatory structures around them are a practical way for retailers to change the cost-benefit equation around retail payments. Moving to in-app payments in the context of a better customer experience that delivers more data at lower cost. This is one of the reasons why I found the recent announcement from Sainsbury's, one the U.K.'s largest retailers, they are going to use Checkout.com to revitalise their SmartShop app so interesting.
- The new functionality will allow customers to pay for their shopping without having to visit a point-of-sale (POS) at all. They will instead pay using the app on their smartphones. Taking the POS out of the payment loop makes it vastly easy to offer different and better payment solutions to consumers.
- Instant Solutions
- This is not a purely European trend, of course, since some US retailers have already been encouraging shoppers to try various forms of "pay by bank" options as alternatives to payment cards (by, for example, using Plaid to link the retailers to customer's bank account) and many observers expect to see a significant increase in the use of such options in the coming year.
- McKinsey report U.S. growth rates for instant payments of more than 60% (admittedly from a small base) and suggest that "there remains room for a breakthrough that sparks an even higher U.S. growth rate". That might be sooner rather than later, because I am pretty sure that the impact of FedNow, the U.S. instant payment network, which is due to be launched later this year, is underestimated in the retail context. As noted by The Economist amongst others, retailers have every reason to switch from paying card issuers to provide incentives to the card issuers' customers and instead routing transactions account to account and providing incentives to their own customers.
- This is just as true in Italy. Rita Camporeale, Head of Payments Systems at the Italian Banking Association (ABI), has said that the pandemic already accelerated the embrace of instant payments in the country, and she has pointed to new use cases emerging among SMEs hoping to improve their cash management practices, initially using the service to move money between their own accounts. As more and more business connect to instant payments, the pressure to use them in retail environments will surely grow.

- At the retail level, there are already two popular payment methodsto compete with cards. Bancomat Pay (run by Bancomat, which operates the domestic card scheme and many of the country's ATM machines) and Satispay both offer mobile apps that allow users to connect their bank accounts with their mobile phones in order to make A2A payments. These can be used by merchants as an alternative to cards already and in some markets (eg, Sweden, where more than eight million consumers and 300,000 businesses already use Swish) we can see A2A volumes building.
- The speed of A2A aside, there is another factor that might accelerate adoption and satisfy the concerns of key Italian stakeholders, and that is privacy. As Diederik Bruggink and Alessia Benevelli from the European Savings and Retail Banking Group wrote in their interesting paper on Instant payments and cards: Apples and oranges or a possible substitute? in the Journal of Payments Strategy and Systems 15(4): p.398-409, one of the key enablers for a flourishing instant payments sector might be privacy. Using account-to-account payments via wallets, where the transaction details are conditionally anonymous, might address European sensibilities around privacy and data protection and meet the concerns of customers who prefer to keep certain transaction details confidential.
- The Path to Retail Instant Payments; I rather agree with Andrew Marshman at FIS who suggested that an open, industry-wide overlay service with interoperable standards could be the way forward, which is why developments around the Single Euro Payments Area Payment Account Access (SPAA) scheme from the European Payments Council (EPC) seem rather interesting. The scheme covers the exchange of payment accounts-related data (eg, between a merchant and a consumer) and the initiation of payment transactions. It is interesting because it leverages investments already made for PSD2 compliance and goes with the grain of the European Commission (EC) legislative proposals around EU "strategy autonomy" in payments.
- The SPAA scheme rule book has just been published and makes for good reading because it was developed collaboratively by the retail payment industry and the users as represented by the Euro Retail Payments Board (ERPB). While there is a lot of work be done to turn these standards into a business, they are certainly an important steppingstone from open banking on towards open finance and eventually open data. The potential for new products and services built on rich data and instant payments is real and significant.
- In the future, a retailer's QR code might trigger customers' smartphone wallets to then push the money directly from their bank accounts while keeping their personally identifiable information safely locked up in a bank vault. Who knows, perhaps in a few years' time the customer's wallet might send central bank digital currency across the internet from her wallet into the retailer's wallet, leaving banking networks out of the loop altogether.

DSB Product Committee : Digital Asset Strategy Sub-Committee : Digital Asset Recommendations Draft

- Members of the DAS-SC are asked to review the attached document which summarizes the recommendations of the DAS-SC that were discussed and approved at the meeting on 14th February 2023.
- As discussed, this document includes the following text regarding the medium-term delivery of DTIs into the Commodity Reference Price enumerated codeset. The text is also provided here:

- "While the DAS-SC does not have a remit to define timelines for DSB tasks (such as the above), the DAS-SC recommended that the extension of the Commodity Reference Price to include a set of DTIs should be an aim of the DSB in its deployment of the UPI. To this end, the DAS-SC also seeks clarification and confirmation of estimated delivery timelines for this enhancement from the DSB."
- Please respond to this email with any comments on this text or the contents of the attached document by COB Thursday 23rd February 2023. If no changes are proposed before that time, this document will be considered final and will be referred to the DSB Product Committee for review and approval and shared with the CDIDE for comment.
- Finally, in order to provide input to the PC's deliberations, members are asked to suggest subjects that might benefit from discussion at future DAS-SC meetings. The following subjects have been proposed…
- ISO 10962 (CFI) Digital Asset Attributes : Recommendations to the CFI Discussion Group for the values to be used within the proposed new CFI Category.
- ISO 10962 (CFI) OTC Derivative Attributes : Recommendations to the CFI Discussion Group concerning the impact of a new CFI Category on the CFI Codes for Swaps, Options and Forwards.
- Crypto asset underlying indicator : Agree the wording of guidance for the handling of this new CDE attribute for OTC derivatives.
- Members of the DAS-SC are asked to respond with addition suggestions by COB Thursday 23rd February 2023.

ECB pushes EU banks to limit crypto holdings The European Central Bank wants banks to treat crypto as a risky asset and begin applying bitcoin holdings caps now, even though the Basel Committee on Banking Supervision's global norms are "not yet legally binding pending its transposition in the European Union." The BCBS has proposed a crypto risk weight that would oblige banks to maintain capital that equals the amount of their crypto holdings and cap the crypto holdings at 1% or less of their core capital. CoinDesk

BTC	% prev	ETH	% prev	BTC.D	% prev
$24,561.00	13.26%	$1,694.70	11.27%	44.33%	2.40%
DXY	**% prev**	**US 10yr yld**	**% prev**	**S&P 500**	**% prev**
103.881	0.29%	3.82%	2.14%	4079.1	-0.28%

(as at 10:00 UTC, source TradingView - prev = 7 days ago)

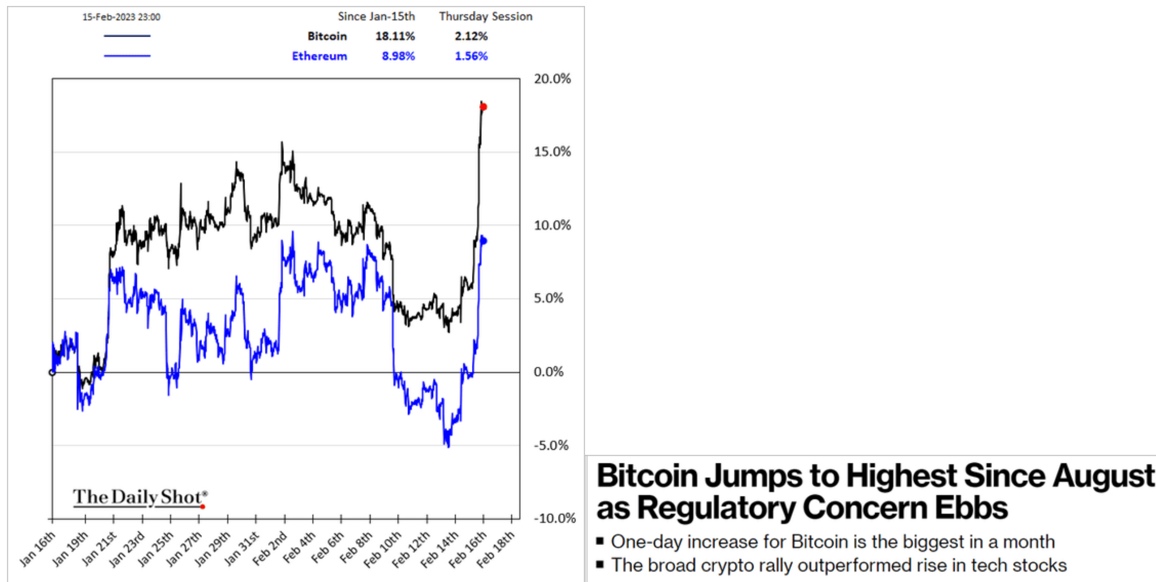
This week felt like something profound had shifted in overall crypto sentiment. That does not mean that it's up-only from here, all rallies have corrections, and there is still (yes, still) potential bad news ahead that could spook traders. Also, the connection between crypto and macro markets has not been broken, and there are clouds gathering over the latter. But this week a different narrative elbowed its way into the spotlight: a focus on liquidity.

- Not crypto liquidity – macro liquidity. And crypto asset performance is currently being led by bitcoin, probably the most liquidity-sensitive play available in the market today.
- BTC has no operating or financing costs, and no cash flows to discount. Rates only impact BTC in terms of liquidity withdrawal and release.

- What's more, BTC is easy to hop in and out of, 24 hours a day and 365 days of the year, unlike other high-risk/high-return assets such as venture equity and other traditional assets such as stocks and bonds. In times of liquidity shifts, this is key.
- Compared to other liquidity-sensitive assets, BTC has arguably suffered more than others, with a >70% drawdown from its November 2021 high. How much lower could it go? BTC has demonstrated signs of a strong support floor for some time – in spite of this week's and last week's bad news for the crypto markets, BTC did not drop notably, and even given the percussion of contagion disasters over the past few months, has held up well. This is no doubt a factor in many investors' timing decisions. (More on this below.)
- Also, unlike other assets such as stocks and bonds, BTC doesn't HAVE to be in any macro portfolios – the lack of weighting requirements put it at the front of the queue to be dumped when liquidity is being withdrawn.
- We saw this at the top of the last cycle: BTC started falling fast much sooner than stocks or bonds, as investors adjusted for the coming liquidity crunch. Now that liquidity seems to be easing, we are seeing investors position to take advantage of the new paradigm.
- And this positioning triggers more positioning. While there could be a correction from here, we know from experience that 1) mainstream investors tend to move as a pack, and FOMO is one of the key drivers of the crypto market, and 2) BTC price action is a very strong marketing tool for the asset (unfortunately).
- A macro move.
- For now, this move feels largely macro-oriented, going by the role of BTC in the market move – BTC tends to outperform when macro investors are taking positions in what they see as the "proxy" crypto asset, with the highest liquidity, lowest non-stablecoin volatility, the liveliest derivatives market and the broadest range of onramps. Bitcoin dominance (BTC.D) jumped…

[Regulator suits against Bankman-Fried paused on DoJ request](#) A request by the Department of Justice to suspend civil proceedings by regulators against FTX founder Sam Bankman-Fried while the criminal case proceeds has been approved by a judge in Manhattan. The DoJ asked for a stay in lawsuits filed by the SEC and the CFTC, given the overlap with its criminal prosecution. [Reuters](#)

Cryptos surged this week.



[CME Group's crypto futures benefiting from crypto enforcement]() The continuing list of crypto industry regulatory actions over the past year has been feeding an increase in crypto futures and options trading on traditional venues. CME Group says its crypto futures average daily trading volume increased by a record 13% in 2022 to 53,600 contracts. [BNN Bloomberg]()

The past week saw two major moves by the SEC against crypto actors that shed light on its thinking around the definition of "security" when it comes to crypto assets. *Last Sunday night, the [Wall Street Journal]() broke the story that the SEC had issued a Wells notice to crypto asset service provider Paxos for violating investor protection laws and for issuing unregistered securities in the form of the Binance stablecoin BUSD.*

- The initial reaction from many was that there was no grounds to declare a stablecoin a security since there is no expectation of profit. But while that is an important prong of the Howey test, it is not a deal-breaker, and the Howey test is not the only securities definition that matters.
- We saw further evidence of this on Thursday, with the news that the [SEC was suing]() Terraform Labs, the company behind the TerraUSD stablecoin, and its co-founder Do Kwon, for misleading investors and issuing unregistered securities. There are some hefty fraud and market manipulation allegations in there as well. This particular action sheds a lot of light on the SEC's security definition thinking:
    - It alleges the algorithmic stablecoin UST was a security.
    - UST apparently represented "rights to subscribe" to a security (LUNA) – this checks the boxes of the "enumerated security" test, a different approach to using the better-known Howey test.
    - Also, UST was closely tied to Anchor, which was marketed as a profitable investment.
    - It alleges that wrapped tokens (blockchain-based assets wrapped in the code of another blockchain to enable interoperability) are securities. A Terra-based example was wLUNA.
    - The SEC also used the "enumerated security" test for this one, and determined that wLUNA was a receipt for a security, and therefore a security.

  - It alleges that mAssets are securities-based swaps. mAssets are blockchain-based assets created to mirror the price performance of real-world assets.
  - The SEC went even further on mAssets, accusing them of violating the '34 Exchange Act by not trading exclusively on registered securities exchanges or ATSs.
  - Terra's sponsorship of a baseball team was mentioned as evidence the whole ecosystem was "for profit". Several of Do's cringe hype master tweets were quoted to the same end.
- The big deal here is that, looking through these arguments to others the SEC is probably preparing, pretty much any crypto asset could be accused of being an unregistered security. This feels like a strategic laying out of a tentative regulatory roadmap while going after the lowest of the low-hanging fruit – Do Kwon is not exactly a popular figure, and probably not in a position to fight this. His current whereabouts are unknown, and he presumably would have to testify were he to want this to go to trial, which – given the Red Notice – would mean instant arrest.
- This going through without a fight would set a strong precedent that could hurt many other assets – and algorithmic stablecoins that in theory use a programmatic peg could be in trouble. We can appreciate the clarity – but dark clouds are brewing for crypto experimentation, which has, even in worst-case scenarios, had very little spill-over into traditional markets. I continue to maintain that disclosure rules rather than blanket bans (which the current registration rules effectively impose) would protect investors while giving them more choice and crediting them with enough intelligence to assess risks, without killing responsible innovation.

SEC proposes tougher custody rules with digital assets in focus; *On February 15th, the SEC proposed a rule that would expand existing investment advisor custody requirements from client funds and securities to "any client assets," including digital assets and art.*

- As a result, investment advisers would be required to deposit this broader range of assets in the exclusive possession or control of a "qualified custodian," which include banks, trusts and registered broker-dealers.
- The definition of "qualified custodian" under the 1940 Act is "a bank or savings association, registered broker-dealer, registered futures commission merchant (FCMs), or certain type of foreign financial institution" that meets certain conditions and requirements.
- The proposal would also require that investment advisors enter into written agreements with custodians containing a number of protections, including that the custodian will.
  - (1) indemnify the client against losses resulting from negligence or misconduct;
  - (2) obtain a report containing an opinion from an external auditor as to the adequacy of its internal controls;
  - (3) segregate client assets;
  - (4) exercise due care in safeguarding client assets;
  - (5) promptly make available client records; and
  - (6) retain its responsibilities in cases of any sub-custodial arrangements.
- The proposal expands the amount of detail required in recordkeeping and contains a long list of questions around issues such as the definition of "qualified custodian" and "possession or control." Comments will be open for 60 days following publication in the Federal Register.

- While the proposal does not discriminate in its expansion of reach to all asset classes, the fact that nearly half of Chair Gary Gensler's accompanying statement focuses on digital assets makes the SEC's primary target clear. Following recent digital asset exchange failures, the SEC has been aggressively taking steps to protect investors, including through enforcement actions, speeches calling for exchanges to register and improve their protections, and now this proposal.
- By requiring investment advisors to keep digital assets at qualified custodians, the proposal would be a significant step in moving investor funds into regulated entities. However, it could in practice add significant complications as
  - (1) in general, investment advisors seeking to transact in digital assets would first transfer customer funds to an exchange, the vast majority of which do not meet the qualified custodian definition; and
  - (2) the nature of many digital assets, often involving the use public keys on decentralized blockchains, make it difficult to demonstrate "exclusive possession or control" by a custodian.
- As the proposal makes its way through the rulemaking process, we expect to see investment advisors and custodians seeking clarity around these points. It is important to note that the new requirements apply broadly to all qualified custodians, including those for traditional securities transactions. Requiring written agreements between investment advisors and custodians is new, and developing them across the industry will require significant lifts from compliance and legal teams. Custodians should also assess whether they need to make changes to bring their programs in line with the written agreements, including whether they need to (1) obtain external audit reports around the adequacy of controls; (2) make improvements to cyber or anti-fraud programs; and (3) conduct additional due diligence on sub-custodian partners.

Senate Banking holds digital assets hearing. On February 14th, the Senate Banking Committee held a hearing entitled "Crypto Crash: Why Financial System Safeguards are Needed for Digital Assets." The committee heard from three academics on the causes underlying digital asset volatility over the last year and potential policy solutions such as a clear regulatory framework including enhanced rules around consumer protection, insolvency, AML and sanctions. The witnesses also discussed the options of granting the SEC authority over spot markets and developing self-regulatory organizations for digital asset exchanges.

Senate Banking Committee Considers Approaches to Crypto Regulation; *In a full committee hearing, the Senate Banking Committee assessed various approaches to cryptocurrency regulation, addressing stablecoin/decentralized finance ("DeFi") regulation, investor protections, and collaboration between the SEC and CFTC.*

- In opening statements, Committee Chair Sherrod Brown (D-OH) said that recent turmoil in crypto markets exposed digital assets as "speculative products run by reckless companies that put Americans' hard-earned money at risk." He said that cryptocurrencies remain a threat to the "real economy" and called for both Congress and regulators to consider how to protect consumers from unregulated digital assets. Ranking Member Tim Scott (R-SC) urged SEC Chair Gary Gensler to appear before the Committee to answer for the lack of accountability that currently exists in the crypto space.

- Lee Reiners, Policy Director at the Duke Financial Economics Center, argued that the SEC should be the primary regulator of crypto exchanges, noting that crypto exchanges in the United States are currently not regulated at the federal level. Mr. Reiners agreed with SEC Chair Gary Gensler's assertion that most crypto assets are securities, but said that some cryptocurrencies, like Bitcoin, should be considered commodities. Mr. Reiners said he supported a comprehensive approach to digital assets that "carve[s] out cryptocurrency from the definition of a commodity in the Commodity Exchange Act and recognize[s] cryptocurrencies as securities under a special definition to the securities laws." Mr. Reiner's testimony also touched on regulating DeFi and stablecoins, saying that forcing stablecoin issuers to become banks could improve the credibility of the product.
- Linda Jeng, Chief Global Regulatory Officer of the Crypto Council for Innovation, focused on developing web3 technology, warning that the United States risks getting "left behind" in innovation if it does not pursue web3 development. She observed that if cryptocurrencies were fully "de-banked," the industry would naturally shift off-shore to other countries or into shadow banking where regulators would lose the ability to monitor and regulate digital asset activities. Ms. Jeng also emphasized the need for regulators to (i) use rulemakings to regulate the crypto space and (ii) not engage in regulation by enforcement.
- Yesha Yadav, Associate Dean at Vanderbilt Law School, proposed establishing a self-regulatory organization ("SRO") to govern the crypto industry. She said establishing an SRO would (i) encourage the rapid creation of a crypto oversight regime, (ii) make the industry assume the cost of its own governance and (iii) provide an opportunity to prove that the industry can regulate itself. In addition, she said the SRO would need to be thoroughly vetted before becoming the governing body for crypto assets, which would assess the firm's "internal governance, risk management, legal and compliance, technical architecture for surveillance, customer monitoring, and systems for protecting customer assets."
- This is going nowhere.
- For whatever reason, the Administration appears bent on killing off digital assets. For all the problems with digital assets, the assertion that they are a threat to the real economy seems overdone. Digital assets just lost at least two thirds of their value and it didn't impact the real economy (*see* FRB Governor Waller's recent remarks, which touch on the "lack of spillovers" to the rest of the financial industry). Regulated financial institutions are not speculating or investing in digital assets.
- The notion of giving the SEC full authority over digital assets would likewise kill the industry, given that the SEC is not interested in developing a governance structure that is suited to digital assets. The approach of the SEC is to (1) say that digital asset issuers must comply with rules that are completely ill-suited to the product, and then (2) protest when issuers do not comply.
- As for establishing an SRO, that sounds well meaning, but it is not realistic. An SRO could possibly work in a situation where there is a small closed club of members that have some association and ties of common interest, but that is definitely not the case with the digital asset industry. It is effectively made up of a bunch of unrelated startups located all over the world. There is no possibility of them joining in an SRO structure; an SRO would have no mechanism to adopt rules and certainly no mechanism to enforce them.

- If this were a business school case study in how government works, one might conclude that the government is not able to respond quickly to change.
- Senate Banking Committee Full Committee Hearing: "Crypto Crash: Why Financial System Safeguards are Needed for Digital Assets"
- Senate Banking Committee Chair Sherrod Brown (D-OH) Opening Statement
- Senate Banking Committee Ranking Member Tim Scott (R-SC) Opening Statement
- Testimony of Lee Reiners, Policy Director at the Duke Financial Economics Center
- Testimony of Linda Jeng, Chief Global Regulatory Officer of the Crypto Council for Innovation
- Testimony of Yesha Yadav, Associate Dean at Vanderbilt Law School

HM Treasury consults on next steps for the regulation of cryptoassets; *On 1st February 2023, HM Treasury published a consultation on its proposed next steps for the regulation of cryptoassets.*
The consultation follows a previous consultation (published in April 2022) on the regulation of fiat-linked stablecoins, which HM Treasury refers to as "Phase 1".
The consultation paper also contains a call for evidence on more nascent areas of the market, so that the government can better understand how those areas could potentially be regulated in the future.
These include decentralised finance, sustainability and cryptoasset activities such as investment advice and portfolio management, post-trade activities including clearing and settlement and crypto mining and validation.

- Policy and background; The consultation sets out further details of Phase 1, as well as proposals to regulate certain other categories of cryptoassets and the trading and investment activities related to them, which HM Treasury refers to as "Phase 2". Overall the proposals are intended to design a regime which achieves the same regulatory outcome for the same risk for crypto assets when compared to traditional asset classes; is proportionate and focused on where the risks and opportunities are most acute; and which is agile and flexible so that it can be adjusted as both the cryptoasset market and international standards develop in the future.
- At the moment there are few clues as to timing but after the consultation process (for which responses are required by 30 April 2023), the government would need to lay secondary legislation, the FCA would need to consult on its approach and the industry would need to prepare for authorisation and the new rules. There are therefore a number of steps, so we would not envisage this regime taking effect until 2025 at the earliest.
- New regulated activities; Importantly, HM Treasury is not discriminating on what forms of cryptoasset can be a specified investments for the purposes of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (RAO). All cryptoassets - security tokens, exchange tokens, utility tokens, NFTs, stablecoins etc. – have the potential to be captured by the regulatory perimeter if specified activities are performed in relation to those cryptoassets.
- The core of the proposals is to expand the scope of regulation to include a number of cryptoasset activities. Many of these resemble regulated activities performed in traditional financial services but there are also some novel cryptoasset activities for which there is no suitable basis in the existing regulatory framework. Persons that carry on certain activities in relation to cryptoassets will need to be authorised to do so under the RAO. Other activities may be subject to requirements to be included in the new Designated Activities Order, which is being legislated for under the Financial Services

and Markets Bill which is current making its way through Parliament. The list of activities below is taken from the consultation paper and is intended to show the types of activities HM Treasury intends to regulate and in which phase.

- Proposed scope of cryptoasset activities to be regulated;

Activity category	Sub-activities (indicative, non-exhaustive)	Phase
Issuance activities	Issuance and redemption of a fiat-backed stablecoin	Phase 1
	Admitting a cryptoasset to a cryptoasset trading venue	Phase 2
	Making a public offer of a cryptoasset	Phase 2
Payment activities	e.g. execution of payment transactions or remittances involving fiat-backed stablecoins	Phase 1
Exchange activities	Operating a cryptoasset trading venue which supports: • the exchange of cryptoassets for other cryptoassets • the exchange of cryptoassets for fiat currency • the exchange of cryptoassets for other assets (e.g. commodities)	Phase 2
	Post-trade activities in cryptoassets (to the extent not already covered)	Future phases
Investment & risk management activities	Dealing in cryptoassets as principal or agent	Phase 2
	Arranging (bringing about) deals in cryptoassets	Phase 2
	Making arrangements with a view to transacting in cryptoassets	Phase 2
	Advising (to the extent not already covered) on cryptoassets	Future phases (or exclude from regulatory perimeter)
	Managing (to the extent not already covered) cryptoassets	Future phases (or exclude from regulatory perimeter)
Lending, borrowing & leverage activities	Operating a cryptoasset lending platform	Phase 2
Safeguarding & /or administration (custody) activities	Safeguarding or safeguarding and administering (or arranging the same) a fiat-backed stablecoin and/or means of access to the fiat-backed stablecoin (custody)	Phase 1
	Safeguarding or safeguarding and administering (or arranging the same) a cryptoasset other than a fiat-backed stablecoin and/or means of access to the cryptoasset (custody)	Phase 2

Validation & governance activities	Mining or validating transactions, or operating a node on a blockchain	Future phases
	Using cryptoassets to run a validator node infrastructure on a proof-of-stake (PoS) network (layer 1 staking)	Future phases

- Firms would need to be authorised where they carry on these activities in the UK or for clients in the UK but there may be an exception for reverse solicitation where a UK customer accesses a service provided by an overseas firm entirely at its own initiative and without solicitation. Some firms may be required to have a physical presence in the UK in order to perform these activities and those operating trading venues may be required to do so from a UK subsidiary in the UK. The requirements here may be informed by the FCA's existing approach to international firms. Interestingly, there is a reference to a desire to pursue equivalence type arrangements where firms authorised outside the UK could provide services in the UK without needing a UK presence provided they are subject to equivalent standards and there are cooperation arrangements in place.
- As well as those currently unregulated businesses needing to apply for authorisation, firms that are already authorised under the Financial Services and Markets Act 2000 would need to apply for variations of their permissions if they wish to carry on cryptoasset activities. There is no discussion as to whether there might be any transitional arrangements for firms that are registered under the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017.
- The FCA will have power to make tailored rules for firms carrying on cryptoasset activities, which would be consulted on at a later stage. However, the consultation paper provides some signposting as to the regulatory outcomes it is aiming for in relation to cryptoasset trading venues, custodians, lending platforms and intermediaries. These give an idea of the key authorisation triggers and criteria, as well as the types of rules the FCA might focus on in particular. Many of these reflect the outcomes that are expected of similar activities in traditional finance but there is a recognition that those rules may need to be adjusted to accommodate the new asset class.
- Issuance and disclosures; Where issuers of cryptoassets want to admit them to trading on a trading venue or make a public offer, the proposed approach is to follow the intended reform of the UK prospectus regime, including its exemptions, with a few adaptations. These would likely give cryptoasset trading venues greater responsibility for setting requirements for admission and disclosure documents in accordance with principles set by the FCA, as well as for due diligence. The FCA will also consider whether ongoing disclosures should be required once a cryptoasset starts trading.
- Market abuse; The government is also considering a market abuse regime for cryptoassets. This would be based on elements of the Market Abuse Regulation and make it an offence for any person to commit market abuse in relation to a cryptoasset admitted to trading on a UK trading venue. This is another area where trading venues would be subject to additional obligations, including to have systems and controls to prevent, detect and disrupt abusive behaviour, and to cooperate with other trading venues for this purpose.
- Practical advice; Anyone engaged in cryptoassets that touches the UK should be considering whether what they do will potentially fall within scope of the proposed regulated and designated activities. They may wish to respond to the consultation and

give views on how those activities should be defined and watch out for the future FCA consultations on how it will adapt its rules to accommodate those activities. Such persons should also prepare for likely authorisation or variations of permission and the potential need to have a UK presence if they do not already have it. Cryptoasset exchanges, in particular, may also need to consider the viability of vertical integration of different functions within their operating models. This thinking should be done in the context of similar requirements being introduced in other countries. Regardless of questions on scope and detailed rules, regulators around the world expect all businesses under their supervision to be run in accordance with appropriate governance, client and asset protection and market integrity, so any improvements to these aspects will not be wasted when more detailed requirements become clearer in due course.

The key considerations for businesses in the sector, based on their regulatory status.

The Treasury's recently launched consultation on cryptoassets has revealed its ambitious plans to regulate the crypto industry. As clarity increases as to the UK's regulatory trajectory, service providers wishing to access the UK market will need to start considering their regulatory strategies.

- UK consultation and call for evidence; As we have discussed, the Treasury kicked off February 2023 by launching a consultation and call for evidence on the future financial services regulatory regime for cryptoassets. In this post, we outline some key considerations for firms in formulating their regulatory strategies.
- Cryptoasset service providers that are not yet registered; Businesses carrying out cryptoasset exchange services or custodian wallet services in the UK are currently required to be registered with the FCA, in accordance with the UK's Money Laundering Regulations (MLRs). That does not mean that all cryptoasset service providers proposed to be caught by the new authorisation regime are already registered. Far from it.
- For one thing, the registration requirements do not currently extend to the full range of service providers that fall within the scope of the Treasury's proposals (such as brokers and lending platforms). The existing registration requirement also only applies where the business is carried out in the UK (unlike the proposed authorisation requirement, which will also apply to overseas firms whose services are available to UK persons). Moreover, most firms that have applied for registration have so far been rejected. As of January 2023, the FCA reported that it had only approved 15% of applications it had determined. All of this suggests that there is likely to be a substantial pool of firms that are not yet registered under the MLRs but which could be caught under the new requirements.
- Some firms will be asking whether it makes sense to seek registration at this stage, when a new authorisation regime is already on the horizon. The Treasury has said that firms that are not yet registered would not need to apply for registration once the new regime comes into effect. They have also said that firms that are already registered will still need to apply for authorisation (as discussed further below).
- The key unknown in all of this is timing. The consultation paper is notably free of any deadlines or forward-looking timeframes. However, it is clear that we are still at the early stages of this process, and there is likely to be a long road ahead, including FCA consultations on the detailed rules.

- In the meantime, firms caught within the MLRs will not be able to carry on their businesses in the UK without a registration. On top of this, changes to the rules on financial promotions will mean that a broad range of service providers (in the UK and overseas) will be prevented from approving their own promotion communications if they are not registered (or otherwise authorised). For firms focused on developing UK market share now, registration may therefore be inescapable, even if it only provides a short-term solution.
- Given the high rejection rate, firms applying for registration should take note of the FCA's feedback on good and poor applications and consider seeking legal advice in advance of submitting an application.
- Cryptoasset service providers that are already registered; *Firms that have already cleared the hurdle of acquiring an FCA registration may have been disheartened to hear that the registration requirement will soon fall away, only to be replaced by a new authorisation requirement.*
- The Treasury is not currently envisaging a grandfathering process as such, on the basis that "*businesses will need to be assessed against a wider range of measures than they have been as part of the MLR registration process*". They have indicated, however, that they will try to smooth the application process for registered firms, by endeavouring to avoid duplicative information requests. They have also sought further feedback as to how the administrative burdens for registered firms can be mitigated. We expect many registered firms will want to take advantage of this opportunity to influence the process.
- But, in any case, obtaining an authorisation is only the first step. Once firms are authorised, they will be faced with a far heavier regulatory burden than they have been used to. The uplift will be greater for some firms than for others. Some firms, for example, have already sought to establish their operations in a manner that is consistent with traditional regulatory standards in order to attract particular segments of the market and/or in anticipation of further regulation. However, even these firms may need to implement new policies and procedures to meet their obligations under the new regime.
- Trading venues, in particular, are facing significant new responsibilities, due to their role as gatekeepers for the industry. The proposals envisage, for example, that they will be ultimately responsible for meeting disclosure requirements for coins admitted to trading on their platforms (in the absence of any issuer picking up the mantle) and for policing market abuse.
- Firms that are already authorised under FSMA; *Firms that are already authorised under FSMA and which intend to offer a newly regulated activity will generally need to apply for a variation of their permission. The Treasury has emphasised that these permissions will not be granted automatically for firms simply because they are already authorised.*
- For such firms, a preliminary question will often be whether the activities they are seeking to undertake fall within their existing permissions. This analysis will not always be straightforward. There is also currently a degree of uncertainty as to the precise scope of the new regimes, particularly given the broad definition of "cryptoasset" in the Financial Services & Markets Bill. The consultation paper does suggest that future regulations will typically use a narrower definition, depending on the precise purpose, but exactly how those definitions will be framed is yet to be seen. Firms exploring arrangements that they would expect to fall outside the scope of the new rules may wish

to consider engaging with the Treasury and the FCA as to where the boundaries should appropriately fall.

- Firms considering authorisation under MiCAR; The Treasury has said that it intends to pursue equivalence type arrangements "*whereby firms authorised in third countries can provide services in the UK without needing a UK presence, provided they are subject to equivalent standards and there are suitable cooperation mechanisms to make this work*".
- This raises an obvious question as to whether firms authorised under the EU's upcoming Markets in Cryptoassets Regulation (MiCAR) will be permitted to access the UK market under such arrangements.
- If any jurisdiction were to get the benefit of such arrangements, the EU seems an obvious candidate. There are substantial similarities between the Treasury's proposals and the MiCAR regime. However, there are also notable differences, including as to scope. It would be highly unlikely that service providers which fall outside the scope of MiCAR but within the scope of the UK's regime would get the benefit of any equivalence measures.
- At the same time, we would expect that in pursuing this objective, the Treasury would at least try to achieve equivalent outcomes for UK regulated firms, in order to allow them to access EU markets without further authorisations. This would certainly be a highly desirable outcome for UK based firms, as well as overseas businesses that prefer the prospect of dealing with UK regulators. Whether this is achievable in a post-Brexit world remains to be seen.
- In any case, firms shaping their regulatory strategies now will welcome answers to these questions sooner

Expression of interest for Synthetic Data Expert Group

- The FCA is looking for members to join its new Synthetic Data Expert Group, a sub-group of the Innovation Advisory Group (IAG). We believe that synthetic data has a role in enabling enhanced capabilities to protect consumers and encourage beneficial innovation in financial services.
- In February 2023, the FCA Innovation department launched the Innovation Advisory Group (IAG) to deepen Innovation's engagement with industry and to inform the FCA's forward-looking work programme. We are now creating a sub-group to the IAG to look at issues related to the use of synthetic data in financial markets.
- The role of the proposed Synthetic Data Expert Group (SDEG) is to:
- Identify relevant use cases and clarify key issues in the theory and practice of synthetic data in UK financial market
- Develop best practice as relevant to UK financial services
- Create an established and effective framework for collaboration across industry, regulators, academia, and wider civil society on issues related to synthetic data
- Act as a sounding board on specific FCA projects involving synthetic data (as appropriate)
- The SDEG will be a sub-group of the IAG and operate within the framework of the IAG Terms of Reference. The SDEG will be chaired by the FCA.
- The SDEG will run for approximately 18 months with the first meeting held in April 2023, with the possibility of extending for another 6 months.

- We are expecting to receive expressions of interest from stakeholder groups such as regulated firms, consultancies, legal professionals, accelerators, consumer groups and academia. Applicants from regulated firms or firms that require authorisation will be considered. We welcome applicants with experience in the field of synthetic data who can commit time to an expert group running likely every 8 weeks or so.
- How to apply
- If you wish to apply, please email a CV and brief cover letter to the Synthetic data expert group mailbox no later than 8 March 2023. Please read the IAG Terms of Reference before applying.

European Blockchain Regulatory Sandbox; *Today the European Commission launched the European Regulatory Sandbox for Blockchain. Sandboxes are controlled environments where companies can test their products and services while engaging with relevant regulators*.

- This Sandbox will provide legal certainty for decentralised technology solutions including blockchain by identifying obstacles to their deployment from a legal and regulatory perspective and providing legal advice, regulatory experience and guidance in a safe and confidential environment. It should also allow regulators and supervisors to enhance their knowledge of cutting-edge blockchain technologies and share best practices through dialogues.
- Running from 2023 to 2026, the Sandbox will support 20 projects annually, including public sector use cases on the European Blockchain Services Infrastructure (EBSI) – a multi-country project under the Digital Decade supported by the Commission, all Member States, Norway and Liechtenstein. The first call will be open until 14 April 2023.
- The Sandbox is supported by the Digital Europe Programme, the EU funding programme focused on bringing digital technology to businesses, citizens and public administrations. It will also help Europe reach its ambition for digital leadership in the Digital Decade, as reducing the legal uncertainty around blockchain will enable its uptake across sectors.
- More information on the Sandbox and information for interested parties can be found on this link: https://lnkd.in/gN7yBGTd
- I just gave ChatGPT the civics portion of the U.S. Immigration and Naturalization test. It got 9 answers out of 10 correct. In order to pass the test, one needs to get 6 out of 10 correct. We need to start the conversation about granting citizenship to AI right about now.
- "Bing's A.I. Chat: 'I Want to Be Alive." (NYT)
  In a two-hour conversation with our columnist, Microsoft's new chatbot said it would like to be human, had a desire to be destructive and was in love with the person it was chatting with.

Costa Rica plans to launch market-maker programme and SLBs; By Burhan Khadbai; Costa Rica's debt management office is preparing for a pivotal year, launching a primary dealership programme for its bond market and issuing ESG bonds.

CBDC: Bank of England offers support for private sector it doesn't trust; By John Orchard; The Bank of England's paper on whether to introduce a CBDC presents sensible reasons to procrastinate for now, while laying the ground to move quickly later.

The Financial Stability Board (FSB) has published a new report on the financial stability risks from decentralised finance (DeFi) and says it will commence additional work to analyse the

risks associated with the model as well as seek to better understand the regulatory scope required for effective oversight.

- The report, which was delivered to the February G20 finance ministers and central bank governors meeting, concludes that while the processes to provide services are in many cases novel, DeFi does not differ substantially from traditional finance in the functions it performs or the vulnerabilities to which it is exposed.
- The FSB says that DeFi's specific features may result in some of these vulnerabilities – such as operational fragilities, liquidity and maturity mismatches, leverage and interconnectedness – playing out at times differently than in traditional finance. "The fact that crypto-assets underpinning much of DeFi lack inherent value and are highly volatile magnifies the impact of these vulnerabilities when they materialise, as recent incidents demonstrate," it states.
- The extent to which these vulnerabilities can lead to financial stability concerns largely depends on the interlinkages and transmission channels between DeFi, traditional finance and the real economy, FSB observes. To date, it says, these interlinkages are limited, "However, if the DeFi ecosystem were to grow significantly, then the scope for spillovers would increase."
- As a result of the report FSB says it will analyse the growth and implications of the tokenisation of assets, as it could increase linkages between crypto-asset markets/DeFi, traditional finance and the real economy. It will also explore approaches to fill data gaps to measure and monitor interconnectedness of DeFi, in collaboration with standard-setting bodies (SSBs) and regulatory authorities.
- The regulator's additional work will also examine the extent to which its proposed policy recommendations for the international regulation of crypto-asset activities may need to be enhanced to acknowledge DeFi-specific risks and facilitate the application and enforcement of rules.
- Finally, the FSB says it will consider, in coordination with the SSBs, the regulatory perimeter across jurisdictions to determine which DeFi activities and entities fall or should fall within that perimeter. This includes considering whether to subject such entities to additional prudential and investor protection requirements or to step up enforcement of existing requirements.

The Financial Stability Risks of Decentralised Finance

16 February 2023

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- On 16 February 2023, the Financial Stability Board (**FSB**) published a report on the financial stability risks of decentralised finance (**DeFi**).
- The report describes DeFi as an umbrella term commonly used to describe a variety of services in crypto-asset markets that are intended to replicate some functions of the traditional financial system by seemingly disintermediating their provision and decentralising their governance. In DeFi, the role of financial institutions and market infrastructures is replaced to varying degrees by self-executing code, or so-called smart contracts, deployed to public blockchains. DeFi emerges primarily as a crypto-based alternative and competitive peer-to-peer/pool marketplace of financial services, covering various activities like trading, borrowing, or lending, so far overwhelmingly within the crypto-asset space.
- The report finds that while the processes to provide services are, in many cases novel, DeFi does not differ substantially from traditional finance in the functions it performs or the vulnerabilities to which it is exposed. DeFi's specific features may result in some of these vulnerabilities- such as operational fragilities, liquidity and maturity mismatches, leverage and interconnectedness – playing out at times differently than in traditional finance. Furthermore, the fact that crypto-assets underpinning much of DeFi lack inherent value and are highly volatile magnifies the impact of these vulnerabilities when they materialise.
- Based on these findings, the FSB will carry out additional work to:
- Analyse the growth and implications of the tokenisation of assets, i.e. the creation of a digital representation (token) of a financial instrument or real asset, as it could increase linkages between crypto-asset markets/DeFi, traditional finance and the real economy.
- Explore approaches to fill data gaps to measure and monitor the interconnectedness of DeFi, in collaboration with standard-setting bodies (**SSBs**) and regulatory authorities.

- Examine the extent to which the FSB's proposed policy recommendations for the international regulation of crypto-asset activities may need to be enhanced to acknowledge DeFi-specific risks and facilitate the application and enforcement of rules.
- Consider, in coordination with the SSBs, the regulatory perimeter across jurisdictions to determine which DeFi activities and entities fall or should fall within that perimeter. It also includes considering whether to subject such entities to additional prudential and investor protection requirements or to step up enforcement of existing requirements.

BINGCHATGPT: The new Bing AI version of search and retrieval (without the chatbot) is much more powerful than ChatGPT. It has some of the same issues (like hallucination and terrible math) but less so, and is capable of some really extraordinary tasks. When I put it to the test, it can do things like read multiple research papers and identify gaps; improve its own writing by asking it to look at online examples of good writing; and do complex analyses integrating diverse information. The work was really, really impressive. There is no doubt it will have a large effect on anyone doing information-based work.I think every organization that has a substantial analysis or writing component to their work will need to figure out how to incorporate these new tools fast, because the competitive advantage gain is potentially enormous. And there is no instruction manual. You can only learn through trial-and-error. We got a glimpse of the future in the past few days, and the gap between ChatGPT (which is already causing waves in many industries) and Bing AI remains enormous. I was not expecting things in AI to keep moving this fast, but now there is every indication they will continue to do so. I don't think anyone knows what this all means, but I think we should be ready for a very weird world. (Ethan Mollick, Professor @Wharton studying innovation & startups)

CHATGPT: Rad or fad? Generative AI is showing all the usual hallmarks of hype: social media echo chambers, exponential venture funding, and a polarized media. But during MS Head of Thematics Ed Stanley's travels around the US last week – ostensibly to discuss decarbonization and reshoring – conversation regularly turned to "and what do you make of ChatGPT?" Ed thinks a broader rethink of valuations may be near. (MS)

- 3 cool examples of ChatGPT usage in the past week: 1) friend's kid using it to help write better stories 2) me using it to learn about genetics 3) a guy emailed to say he's using it to help run his one-man small business—help with marketing, data entry, customer support, etc (S. Altman, CEO of OpenAI)
- ChatGPT Fervour Is So Hot That Chinese Firms Call for Caution (BBG) PeakGPT?
- Tips from all over the world on how to use ChatGPT effectively: ChatGPT cheat sheet (https://quickref.me/chatgpt)
- Sam Altman, CEO of OpenAI: "society underestimates how much it owes Elon for raising the collective ambition level at a time when optimism for the future was receding".
- SAM ALTMAN (CEO OPENAI): 2023: $30,000 to get a simple iPhone app created, $300 for a plumbing job. i wonder what those relative prices will look like in 2028! the likely coming divergence between changes to cognitive work and changes to physical work could be quite dramatic plumbers are NOT so cheap..

Embedded Finance And The End Of Traditional Banking; David Birch; ; A market research survey of more than a thousand senior decision makers in the UK, Belgium and the Netherlands — commissioned by Polish banking-as-a-service (BaaS) platform provider Vodeno — found that two-thirds of them said that BaaS is transforming financial services for the better (I find it

surprising that a third didn't, frankly) and, more interestingly, half of them said that it will eventually make "traditional" banking obsolete.

That may seem a radical prediction, but I think it is entirely reasonable. Banking isn't fun or interesting and most people (me included) don't really want to spend any of their valuable time or attention on what is essentially a heavily regulated utility service. Most people (me included) would prefer to have their financial services delivered to them at point of need without interrupting their experiences. As Christina Melas-Kyriazi (a partner at the management consultancy Bain) observed, if you want to deliver financial services to a person then in some cases the best way to get to that person can be "via software, where they're doing their work".

- Indeed.
- Europe and the U.S are heading in the same direction here: Bain estimates that all kinds of financial services (not only banking) embedded into software accounted for $2.6 trillion, or nearly 5%, of total US financial transactions in 2021 and will approximately triple to $7 billion over the following five years.
- (Note that point about this being all kinds of financial services and not only banking.)
- While the market is currently dominated by payments and lending services, the upward trajectory will draw in adjacent value-added services as well. Bain suggest insurance, tax, and accounting as obvious candidates.
- (Thomas Bravo's recent acquisition of Coupa illustrates the market dynamics. Embedding payments functionality into other business management functions is of particular value. SaaS companies such as Avidxchange and Bill.com, as example, obtained two-thirds and one-third respectively of last years' revenue from such services.)
- It is no surprise to see so much investment heading in this direction. An FIS global survey of 2,000 executives at firms across markets revealed plans to increase investment in embedded finance, environmental, social, and governance (ESG) frameworks and (rather interestingly, in my opinion) decentralised finance this year. Almost half of the financial services firms' executives surveyed said that they will invest "significantly" in developing embedded finance products as consumers demand more convenient ways to transfer value in time, space and scale.
- Fintechs and Techfins
- What will this mean for fintech? On the other hand, the ability to deliver financial services inside consumer-centric experiences means better customer experiences but on the other hand, it means serious competition from the techfins. As Sophie Guibaud and Scarlett Sieber wrote in their 2022 book *Embedded Finance: When payments become an experience* (in the chapter on "Big Tech and Beyond", pages 45-68) it makes sense for the technology players to move in this direction because they companies know their customers, have strong relationships with them and can use their data to predict their needs, offering the right products, at the right price and at the right time.
- The techfins are more than happy to have banks, for example, do the boring, expensive and risky work with all of the compliance headaches that come with it. Big Tech does not care about the manufacturing of financial products, what it wants is the distribution side of the business. Given that they have no legacy infrastructure (e.g. branches), their costs are lower and the provision of financial services helps to keep their customers within their ecosystems.
- It is easy to imagine a future where you use an Apple checking account (actually provided by JP. Morgan) and an Apple credit card (actually provided by Goldman Sachs)

and use an Apple loan (actually provided by Wells Fargo) to buy your Apple glasses, then Apple will have a very accurate picture of your finances. A very accurate picture indeed.

- It's All About Data, Again
- The business model here is clear. As I have written here before, what Big Tech wants isn't your money, but your data. The margins on money are shrinking, after all. According to McKinsey, "traditional" banks face stagnant or decreased revenue and profits. They note that the average global banking return-on-equity was around 9.5% in 2021. This is a sharp decline from 15% prior to the 2008 crisis and on the way to a projected 7% at the end of the decade.
- One particular segment where this is having quite an impact is small business lending. A Bank for International Settlements working paper (no. 1041, September 2022) notes that fintechs (they look at Funding Circle and Lending Club) lend more than banks in areas where there would appear to be poor credit environment. The paper identifies the competitive threat to banks and concludes that such players can "create a more inclusive financial system, allowing small businesses that were less likely to receive credit through traditional lenders to access credit and to do so at a lower cost."
- Why? Well, as you might expect, this about technology. The fintechs can evaluate credit risk using information beyond basic credit scores to emulate (and enhance) the local knowledge that used to be the domain of local banks. They cite the ability to access customer ratings and reviews as a good example of the "soft" data that can helpfully inform credit decisions. As Jonathan Katz comments about this over at The Financial Brand, banks that access such data stand to benefit from the business insight it provides, but note that it is insight that behemoths such as Amazon already have access to.
- Imagine how much more accurate Big Tech's decision-making can be when feeding the machine-learning algorithms with their hoards of data. If we want a better financial services sector then we must find ways to create a more competitive sector and that will mean moving on to some form of open data environment that delivers not merely financial services, but financial health, which is one of my favourite topics.
- Powering Financial Health
- There was a good piece in the *Harvard Business Review* a couple of years ago where Todd Baker and Corey Stone explored interesting ideas around the transition from individual financial services to integrated financial health. In that article they pointed out that the prevailing paradigm (of markets and choice) created a regulatory system that "largely places responsibility — absent the most egregious abuse — on the individual consumer" and argue for a radically different regulatory structure to more directly connect the success of financial services providers to their customers' financial health.
- (They draw an interesting analogy by comparing this approach with experiments in the American health marketplace that pay providers for improving patients health, "rather than paying them simply for treating patients regardless of the outcome of the medical intervention".)
- The incumbents have a problem here as well. Not only do not they have the data that Big Tech does, but according to findings from the J.D. Power 2022 U.S. Retail Banking Advice Satisfaction Study (based on responses from 5,177 U.S. retail bank customers who received financial advice or guidance from their primary bank in the past 12 months), overall customer satisfaction with the advice and guidance provided by national and regional banks has actually gone down over the last year.

- What's more, less than half of US customers use any form of financial health tool offered by their bank at all, which is a little disappointing considering how much banks invest in their digital apps, especially since research shows that customer satisfaction with how their bank supports their financial health rises sharply with use of such tools.

- *with kind permission of Helen Holmes (CC-BY-ND 4.0)*
- So how can banks persuade people to use those tools? This is important, because customers need advice. Financial literacy is generally poor and the financial landscape is complex so you do have wonder whether it makes sense to try and use tools to educate consumers at all, especially when a substantial fraction of those consumers have poor literacy and digital skills, never mind financial literacy and money skills.
- (Credit card rewards are an ideal laboratory for exploring this topic. Here research shows clearly that rewards programs redistribute income from naıve to sophisticated consumers, supporting related studies that link heterogeneity in asset returns with measures of financial literacy.)
- Maybe it would be better to instead provide consumers with intelligent agents to act on their behalf.
- Robotrust
- Why would customers trust the banks' bots though? In the UK, I think this might be one of the unexpected consequences of an impending regulatory change. Last year, the U.K.'s FCA (FCA) confirmed its plans to bring in a new "\Consumer Duty", which will fundamentally improve how firms serve consumers. It will set higher and clearer standards of consumer protection across financial services and require firms to "put their customers' needs first".
- What this means in practice is that companies will need to review their products (and their governance) to make sure that that the best choices are made for consumers, not for the financial services providers. It's a sort of duty of care, but for money, and it's a real step forward to the delivery of integrated financial health rather than isolated financial products. Within this framework, it makes obvious sense for intelligent agents to act on the consumer's behalf.
- (I just spent several hours researching for, applying for and funding a new savings account and I'm still not sure whether I made the best decision or not. I'd much rather have had a bot operating under a regulated duty of care do this sort of thing for me.)
- Refocusing the sector on delivering financial health, rather than financial services has implications that go way beyond choosing better credit cards or spending less on coffee and more on pensions but in order to do this, financial health providers will need a better picture of individuals and their circumstances. They need the raw data to work with. This is where the connection with open banking, open finance and open data comes from

and when you look at trends in this context, the idea that people will access traditional banking services through traditional bank interface does indeed appear quaint.

- Incidentally, as I was editing this article, I saw Shaul David's comment on the news about Tesco considering divesting their bank. His point was that neither Tesco nor any other retailer needs a bank. What they need is a good embedded finance strategy, because there are many reasons why Tesco could be just as good a financial health provider to a great many people as a bank good. For one thing, Tesco knows what people spend their money on and for another it has distribution, brand and well-founded expectations of redress that are the potential foundations of a much better business than low-margin heavily-regulated core banking.

The UK Jurisdiction Taskforce has published a legal statement confirming that English law already supports a range of digital securities structures without the need for statutory intervention. *This is a highly welcome development for the market. In this publication, we answer twelve frequently asked questions on the conclusions and implications of the legal statement.*

- UKJT Legal Statement on Digital Securities
- Linklaters FAQs on the UKJT Legal Statement on Digital Securities

The UK Jurisdiction Taskforce (UKJT) has published a legal statement on the issuance and transfer of digital securities under English private law.[1] The UKJT is one of six taskforces of the LawTech Delivery Panel, an industry-led group that is tasked with supporting the digital transformation of the UK legal services sector, and is chaired by Sir Geoffrey Vos, Master of the Rolls.

This legal statement provides the market with a high degree of legal certainty that English law supports a range of digital security structures. We expect this will be a catalyst in the development of the digital securities markets, particularly given that English law has historically been a preferred governing law for debt and other contractually based securities in the Euromarket.

Richard Hay, Linklaters' UK Head of Fintech, was one of the drafters of the legal statement, together with a number of respected barristers. Michael Voisin (Partner) and Sophia Le Vesconte (Senior Knowledge Lawyer) also contributed to successive drafts.

Below, we consider the key takeaways from the legal statement.

1. What is the legal statement?

The legal statement ("**LS**") is a statement of the law as it currently stands, written by five lawyers (Lawrence Akka KC, David Quest KC, Richard Hay, Matthew Lavy and Sam Goodman). It was commissioned by the UKJT in order to address areas of perceived legal uncertainty under English law and follows a market-wide consultation to consider which questions the LS should address.

Although the legal statement does not, strictly speaking, have the force of law or constitute formal legal advice, we expect the English courts (and, indeed, courts in other common law jurisdictions) to give very significant weight to it. The first legal statement published by the UKJT (on the legal status of cryptoassets and smart contracts) has been adopted not only by the English courts, but also by courts in other jurisdictions. It has been instrumental in establishing the now broad consensus that cryptoassets are capable of attracting property interests in England and in many common law jurisdictions.

The LS, like the UKJT's first legal statement, can be compared in terms of its persuasive authority to a formal legal opinion commissioned by a trade association to resolve matters of legal uncertainty and which is generally adopted by market participants as outlining the market consensus as to the legal basis on which the relevant market transacts.

The LS is primarily focused on matters of English private law concerning the issuance and transfer of Digital Securities (defined in FAQ 3 below). It does not address questions of financial regulation (including securities regulations, settlement finality, prudential regulation and anti-money laundering rules), taxation, criminal law, partnership law, data protection, intellectual property or consumer protection.

The LS also does not seek to address questions around conflicts of laws (such as which law governs transactions in respect of assets constituted through a cross border distributed ledger, and which court has jurisdiction to hear disputes). The Law Commission is expecting to publish a consultation paper on this topic later this year.

> The LS provides a high degree of legal certainty to participants in the financial markets that English law already supports a range of Digital Securities structures, without any need for statutory intervention.

[1] References in these FAQs to English law and jurisdiction are to English and Welsh law and the jurisdiction of England and Wales.

2. What are the implications for the market?

The LS provides a high degree of legal certainty to participants in the financial markets that English law already supports a range of Digital Securities structures, without any need for statutory intervention (for example, a specific law on blockchain or distributed ledger technology ("**DLT**")). This will be strongly welcomed by innovators across the global financial markets, particularly given the status of English law as a preferred law for the constitution, trading, clearing, custody and settlement of financial instruments that are traded globally.

Digital transformation, in particular through the deployment of blockchain or DLT, is an area of focus for many institutions operating in the financial markets. In some cases, some perceptions of legal uncertainty under English law have slowed the development of English law solutions in the market or led participants to consider using legal systems that they would not otherwise choose. Specifically, there has been a perception that the lack of targeted legislation that provides a legal basis to underpin the issuance of Digital Securities governed by English law makes English law less attractive compared to the law of other jurisdictions that have enacted such legislation. The LS has addressed this perception by clarifying that English private law can already accommodate Digital Securities.

Of course, where the issuer of a Digital Security is incorporated in a jurisdiction other than England, it will also be necessary to determine whether that jurisdiction imposes any formalities or requirements, but this will be the case regardless of the governing law of the Digital Securities.

3. What are Digital Securities?

Broadly speaking, the term "**Digital Securities**" is used to refer to securities that are constituted, recorded and/or transferred using blockchain technology or DLT. Blockchain or DLT can also be used to record and transfer interests in securities, and we refer to these types of arrangements as "**related structures**" in this FAQ. The LS is primarily focused on Digital Securities, but some of the issues discussed in the LS are also relevant in the context of related structures.

Appendix 4 of the LS sets out some illustrative examples of Digital Securities and related structures that are currently contemplated in the market. These include (without limitation):

- a company issuing a token representing a Digital Security directly onto a blockchain and promising to perform its obligations in favour of the holder from time to time;
- a registrar acting on behalf of a company, or a third-party operator acting on a principal basis, using a blockchain and/or distributed ledger as a record of holders of the company's Digital Securities from time to time;
- an intermediary with whom conventional securities are immobilised, or in favour of whom conventional securities are recorded, causing a token to be deployed on a blockchain and/or distributed ledger that represents or records a beneficial or other interest in those underlying conventional securities; and
- a central securities depository treating a blockchain and/or distributed ledger as its books and records in respect of the initial recording of Digital Securities and allowing for ordinary course transactions to be validated on a decentralised basis in accordance with an agreed protocol.

Different types of Digital Security may be treated differently for regulatory purposes, depending on their exact nature. The LS does not address regulatory categorisation. We discuss the general application of financial regulation in FAQ 12 below.

4. Can English law accommodate Digital Securities?

In short, yes. The LS concluded that Digital Securities may be constituted and transferred under English law using a properly constructed set of arrangements.

As discussed under FAQ 9 below, certain legal formalities may apply, but these formalities can either be avoided through appropriate structuring or met through electronic means.

5. In what forms can Digital Securities be validly constituted under English law?

The analysis in the LS allows us to conclude the following:

- **All types of Digital Securities** can be constituted using English law in **traditional registered form**, whereby a blockchain or distributed ledger serves as a register of interests in the Digital Securities, maintained by the issuer or a registrar acting on its behalf, subject to compliance with applicable formalities, as discussed under FAQ 9 below.
- **Digital bonds and other contractual securities** can be constituted in a form akin to traditional bearer form, whereby the rights comprising the digital bond are attached to a token (or other digital form of property) under the exclusive control of the holder (rather than to a physical document). We refer to this as **digital bearer form**.
- **Digital bonds and other contractual securities** can also be constituted under a structure whereby a blockchain or distributed ledger is used as a **record of holders maintained by a third party** acting on a principal basis or through a decentralised consensus mechanism, rather than a registrar acting on behalf of the issuer. We refer to this as **digital claim form**.

See paragraphs 26 – 31, 67 – 70, 80 and 139 – 143 of the LS.

6. How may Digital Securities be transferred under English law?

The mechanism for transfer depends on the form of the Digital Security. The LS concludes:

- Digital Securities **issued by UK companies in traditional registered form** can be transferred using a "proper instrument of transfer" in accordance with the Companies Act 2006, as discussed further under FAQ 9 below. *See paragraphs 157 - 158 of the LS.*
- For Digital Securities in **digital bearer form**, the mechanism of transfer will be the transfer of practical control of the token to which the rights comprising the Digital Securities are stapled. *See paragraphs 39 – 58, 84 - 87 and 150 – 151 of the LS.*
- For Digital Securities in **digital claim form or, in traditional registered form in respect of a non-UK company**, the mechanism of transfer will depend on the means by which the rights constituting the Digital Securities are stapled to records in the blockchain or DLT-based system. *See paragraphs 84 – 87 and 150 – 151 of the LS.*
- In contrast to some other jurisdictions, there is no single methodology for stapling Digital Securities to a token or record in a blockchain or DLT-based system under English law. Rather, there are various alternative mechanisms that can be used, depending on which structure best meets the parties' needs in the circumstances. These include (but are not limited to) deeds poll, The Contracts (Rights of Third Parties) Act, novation with advance consent and multilateral contractual frameworks, all of which apply similarly whether the Digital Securities are being stapled to a token that is an object of property or to a record in a blockchain or DLT-based system which is not. *See paragraphs 88 – 118 and 146 of the LS.*

Taxonomy Is Important – What Are "Digital Assets"?

While there is no single, widely-accepted definition of "digital assets," it can generally be viewed through three lenses:

CRYPTOCURRENCIES

- Virtual currencies not backed by assets
- Depends primarily on cryptography and distributed ledger or similar technology

DIGITAL CASH

- **Deposit Tokens**: Represent traditional cash deposits on chain for intrabank transfer purposes
- **Stablecoins**: Privately issued; aim to maintain value relative to a specified asset or pool of assets and satisfy criteria related to redeemability and reserves
- **Central Bank Digital Currencies (CBDCs)**: Publicly issued by central banks; complement existing forms of fiat in two forms: retail (households and businesses) and wholesale (financial institutions)

TOKENIZED ASSETS

- Digital representations of traditional assets using cryptography, distributed ledger, or similar technology
- Potential for native issuance on a distributed ledger

<table>
<tr><td colspan="2">A. Value-Stable Digital-Assets</td></tr>
<tr><td>1. Central Bank Digital Currencies (CBDC)
(e.g., e-Krona):</td><td>Digital form of money that represents a liability of a central bank in a single fiat sovereign currency that may or may not pay interest</td></tr>
<tr><td>2. Financial Market Infrastructure (FMI) Tokens
(E.g., USC) :</td><td>Digital form of money representing claims on an FMI and reflecting deposits held at a central or commercial bank in a single fiat currency that may or may not pay interest</td></tr>
<tr><td>3. Tokenised Commercial Bank Money
(e.g., Signet):</td><td>A token evidencing a deposit claim for a fixed amount of fiat money denominated in a single currency by the token-holder against the token issuing bank or other similarly highly regulated depository institution. It may or may not pay interest.</td></tr>
<tr><td rowspan="2">4. Stablecoins:
Tokens designed to minimise/eliminate price fluctuations relative or in reference to other asset(s) which are not issued by a central bank, FMI, bank, credit institution or highly-regulated depository institution. May represent a claim on the issuing entity, if any, and/or the underlying assets</td><td>a. Asset Linked Digital-Asset – value may be fixed or variable and in reference to individual structures or include a combination of:
• Fiat currency linked (e.g., Tether, Paxos, USDC, Gemini)
• Other real asset linked (e.g., Sendgold, Xaurum)
• Digital asset linked (e.g., Maker)</td></tr>
<tr><td>b. Algorithmic Digital-Asset: Typically, not linked to any underlying assets and each token can be pegged to a price level or a unit maintained through buying, selling or exchange among assets or some other pre- determined mechanism.</td></tr>
<tr><td colspan="2">B. Security Token</td></tr>
</table>

Types of Digital Assets	Token issued solely on DLT or blockchain infrastructure that satisfies the applicable regulatory definition of a security i. or financial instrument under local law (e.g., World Bank's' Blockchain Bond')
	Token that represents on DLT or blockchain infrastructure underlying securities/financial instruments issued on a different platform (e.g., a traditional CSD, registrar, etc.), where such representation itself satisfies the definition of a security/ financial instrument under local law.
C. Cryptocurrencies	
Digital representations of value with no redemption rights against a central party and may function within the community (enabled through peer-to-peer networks) of its users as a medium of exchange, unit of account or store of value, without having legal tender status. They may also act as an incentive mechanism and/or facilitate functions performed on the network they are created in; their value is driven by market supply/demand therein.	
D. Settlement Token	
Representation on DLT or blockchain infrastructure of underlying traditional securities/ financial instruments issued on a different platform (e.g., a traditional CSD, registrar, etc.) where such representation itself does not satisfy the definition of a security or financial instrument under local law and is used solely to transfer or record ownership or perform other mid/back-office functions (e.g., collateral transfer, recording of ownership)	
E. Utility Token	
A means of accessing a DLT or blockchain platform and/or a medium of exchange which participants on that platform may use for the provision of goods and services provided on that platform (e.g. loyalty rewards programs/systems, gift card rewards, credit points that are only usable within the DLT or blockchain platform, memory and network server space, and other utilities- based value);	
Tokens that are not native to the underlying network but are used for accessing applications that are built on top of another DLT or blockchain infrastructure platform (dApp) F. Other Crypto-Assets (not structured as value-stable crypto-assets)	
Representation on DLT or blockchain infrastructure of ownership in tangible or intangible underlying assets or of certain rights in those assets (such as interest, e.g., loans), which are not securities or financial instruments (e.g., real estate, art, intellectual property rights, precious metals, grains, or non-fungible assets that only exist in digital form on a DLT network); they may represent a claim on the issuing entity or the underlying assets	

ISDA, ICMA - International Capital Market Association and International Securities Lending Association (ISLA) are holding the CDM Showcase in London today, highlighting the multiple ways in which the Common Domain Model is being used to bring greater automation and efficiency across financial markets.

- In his welcoming remarks, ISDA CEO Scott O'Malia gave an overview of ISDA's work to apply the CDM to both digital regulatory reporting and collateral management. "Recent market shocks have shown how important it is to bring greater efficiency and automation to collateral management, enabling firms to manage the spike in margin calls that comes when volatility strikes," said O'Malia.

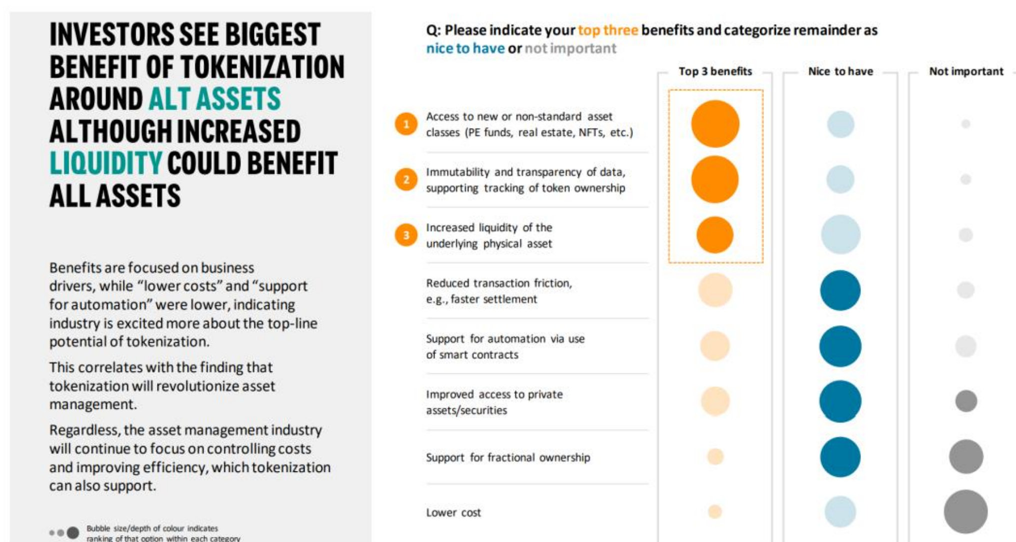
- Today's program has been designed to showcase the multiple ways in which the CDM is being used today to bring greater automation and efficiency. From derivatives regulatory reporting to bond issuance and repo transactions, the model is already bringing the benefits of standardization and digitization to key markets and processes.
- It's nearly five years since we brought out the first iteration of the CDM. Our vision was clear – to provide a standard digital representation of events and processes that occur during the trade lifecycle, in a machine-readable format. We wanted to increase interoperability between systems, cut down resource-heavy reconciliations and pave the way for automation across markets, enabling firms to function more effectively, with less strain on resources and at a cheaper cost.
- That vision was given a big boost in 2021, when ISDA signed a memorandum of understanding with ICMA and ISLA to work together on the development of the CDM, helping to ensure a coordinated, joined-up approach in how the model is applied across derivatives, bonds, and securities finance markets. Last year saw another big step in the development, with the appointment of FINOS to oversee maintenance of the CDM code and help further build a community to contribute to the development of the CDM.
- During the course of today's event, you'll hear a number of case studies that will show how the CDM is being deployed and what opportunities lie ahead. At ISDA, we have successfully applied the model to our digital regulatory reporting (DRR) initiative and collateral management, and we're already seeing the benefits.
- It's no secret that derivatives reporting isn't yet working as it should. This was one of the key market reforms following the financial crisis, but differences in reporting requirements between countries and the lack of a common approach to reporting led to inaccuracies, omissions, and duplication in reported data.
- Policymakers have responded to these issues by developing international data standards, which set out a common format for how trades should be defined and reported. As regulators around the world revise their reporting requirements to integrate these critical data elements, it is vital that updates to rulebooks are interpreted and implemented consistently. Once market participants have developed a common interpretation, the CDM enables the coding of that interpretation to ensure consistent implementation.
- In December 2022, the US CFTC (CFTC) implemented the first phase of changes to its swap data reporting rules, integrating many of the globally-agreed critical data elements. Together with our members, ISDA used the CDM to express a mutualized, industry-agreed interpretation of the CFTC's amended rules as open-source, machine-executable code. This code could either be used as the basis for implementation of the CFTC rules, or to validate an independent interpretation.
- With the first phase of the CFTC Rewrite now behind us, we're working to extend the benefits of the DRR to other jurisdictions, including the EU, where changes to reporting rules are due to come into effect in April next year. We're also focused on reporting rule changes in Canada, the UK, and jurisdictions across Asia Pacific. While each rule set needs its own unique code, the lion's share of the coding has already been achieved with the CFTC rules, making it easier to roll out the initiative to other markets.
- One of the great benefits of using the CDM to code and implement complex regulatory requirements is the ease with which further rule changes can be implemented. In the future, we anticipate that regulators will be able to publish new rules as machine-executable code that can be interpreted and implemented automatically. This has the

potential to revolutionize the process of implementing regulation, eliminating the potential for inconsistencies, while also creating significant efficiencies and savings.

- Our use of the CDM doesn't stop with regulatory reporting. We're also applying the model to collateral management, where a lack of end-to-end automation and excessive reliance on manual intervention makes critical processes time-consuming and prone to errors. Recent market shocks have shown how important it is to bring greater efficiency and automation to this space, enabling firms to manage the spike in margin calls that comes when market volatility strikes.
- The CDM use cases we have developed can streamline counterparty onboarding, automate cash collateral calculations and payment processes, and reduce negotiation time on eligible collateral schedules, bringing significant efficiencies and reducing counterparty, liquidity, and operational risks. We've developed a new fact sheet on our work in this space, so please do take the opportunity to take a look at that.

Increasing Interest in Tokenized Assets

Motivations vary – expanding access to investors, increasing liquidity, enhancing transparency etc.



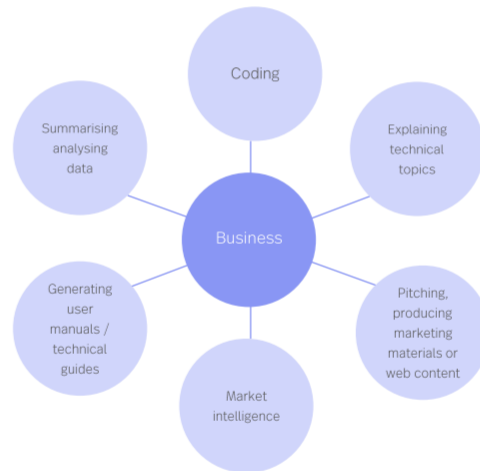
BIS says forget stablecoins, focus on other innovations Central banks should focus on the development of infrastructure for innovations like tokenized deposits and central bank digital currencies, since there are "serious doubts" about the reliability of stablecoins as a form of money, Bank of International Settlements chief Agustin Carstens said during a speech in Singapore. Carstens said that "it is incumbent upon central banks to make sure they contribute to developing an infrastructure that meets these demands: if central banks do not innovate, others will step in." The Block

- SEC eyes stablecoins for possible enforcement action The US SEC is examining whether stablecoins linked to the US dollar violated investor-protection law. However, lawyers say that any SEC action would prove challenging since users of stablecoins don't expect profits and both the US CFTC and the New York State Department of Financial Services view stablecoins as "virtual currencies." The Wall Street Journal

Thank you for attending Demystifying ChatGPT: Practical application, risks, and opportunities. This webinar is now on-demand, should you like to view it again.

Our views on Use Cases

Our Views – Use Cases



What will the generative AI future hold?

Our Views on Risks

BINGCHATGPT: The new Bing AI version of search and retrieval (without the chatbot) is much more powerful than ChatGPT. It has some of the same issues (like hallucination and terrible math) but less so, and is capable of some really extraordinary tasks. When I put it to the test, it can do things like read multiple research papers and identify gaps; improve its own writing by asking it to look at online examples of good writing; and do complex analyses integrating diverse information. The work was really, really impressive. There is no doubt it will have a large effect on anyone doing information-based work.

- Wall Street is clamping down on ChatGPT with Citigroup Inc. Goldman Sachs Group Inc. and Wells Fargo & Co. all imposing restrictions on the fast-growing technology that generates text, images and other media in response to a short prompt. Citigroup has blocked access to the product, part of automatic restrictions that are imposed around third-party software, a person familiar with the matter said. Goldman's traders are similarly restricted, another person said. Wells Fargo is doing likewise under standard control procedures for implementing third-party software, according to a spokesperson for the bank. /jlne.ws/3ZlnTUX
- CHATGPT: ChatGPT outputs already feel like old hat vs what people are posting from Bing. But still seems impressive to me!
- China's Top Broker Says ChatGPT Did Well in Research Assignment (BBG); Analysts at Chinese brokerage CICC asked ChatGPT to write a 2023 market outlook to prove that

humans are still needed. Well the machines are bullish on equities and gold, cautious on bonds and commodities.

- TIKTOK: : European Commission is set to ban TikTok on official devices.
- **I think every organization that has a substantial analysis or writing component to their work will** need to figure out how to incorporate these new tools fast, because the competitive advantage gain is potentially enormous. And there is no instruction manual. You can only learn through trial-and-error. We got a glimpse of the future in the past few days, and the gap between ChatGPT (which is already causing waves in many industries), and Bing AI remains enormous.
- **I was not expecting things in AI to keep moving this fast, but now there is every indication they** will continue to do so. I don't think anyone knows what this all means, but I think we should be ready for a very weird world. (Ethan Mollick, Professor @Wharton studying innovation & startups)
- **From CEOs to Coders, Employees Experiment With New AI Programs; ChatGPT's release has sparked a rush of early adopters eager to speed up tasks or avoid being left behind**; Shortly after the release of OpenAI's ChatGPT in November, Jeff Maggioncalda, the CEO of online education company Coursera Inc., jumped into the technology to see if it could save him time. He began using the chatbot to draft company letters and notes and asked his executive assistant to try the same for drafting replies to his inbound emails. She prompts ChatGPT based on how she thinks he would respond, and he edits the answers it generates before sending. /jlne.ws/3XLPcXg
- **BING AI: I automated the Stanford Design School! Maybe that is an exaggeration, but in just five** queries, Bing AI took me through a design thinking loop, including using web data to make empathy maps, coming up with ideas, proposing prototypes, & faking user transcripts. Quite a tool. It is very much unexpected how much of the disruptive possibilities of AI are going to impact highly-skilled, complex analysis. (@emollick Professor at Wharton studying innovation & startups.)
- **JPMorgan Restricts Employees From Using ChatGPT; Verizon and other organizations have also blocked access to the popular AI chatbot**; JPMorgan Chase & Co. is restricting employees from using ChatGPT, according to a person familiar with the matter. The bank didn't restrict usage of the popular artificial-intelligence chatbot because of any particular incident, the person said. It couldn't be determined how many employees were using the chatbot or for what functions they were using it. /jlne.ws/3Eyg7yP

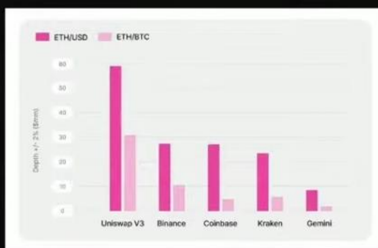
Blockchains can be open or closed

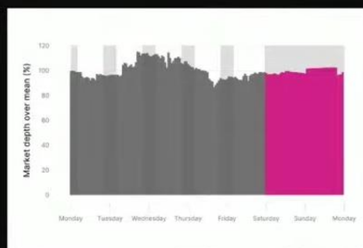
Open systems allow for interoperability, improved security and transparency

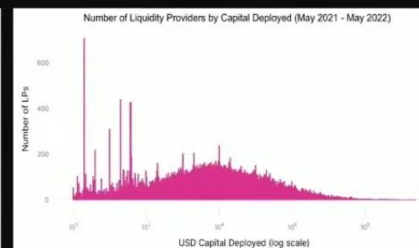
- **Interoperability:** Market activities — lending, swapping — can be developed as modules. These can integrate with each other without requiring bilateral agreements
- **Security**: Publicly-released code allows for rapid identification of vulnerabilities
- **Transparency:** Anyone can trust and verify transactions and that the system is running as expected in real time

Central banks are experimenting with Automated Market Makers because of their structural advantages

Examples: MAS' Project Guardian, BIS' Project Mariana







>50% deeper liquidity on Uniswap Protocol vs. centralized exchanges

Consistent liquidity across time and day

Democratizes liquidity provision by allowing 100k+ participants

What might drive progress?

Distinguish beneficial blockchain applications from hacks, scams and bad behavior

- Encourage public-private sector collaboration on DeFi
  - e.g., Monetary Authority of Singapore and Bank of Int'l Settlements' projects
- Highlight future financial and non-financial applications, e.g., patient records, tracking goods
  - California DMV plans to use blockchain technology to verify car titles and registrations
  - 94% of surveyed Fortune 500 executives have blockchain project plans

Stablecoins Attract Scrutiny in SEC's Drive to Control Crypto; Agency investigates whether the cryptocurrencies' issuance violated investor-protection laws; Washington's battle to rein in crypto has a new front: stablecoins. The SEC is investigating whether stablecoins, cryptocurrencies that maintain a price of $1, are among the products that were issued in violation of investor-protection laws. SEC enforcement lawyers have told Paxos Trust Co. that regulators plan to take enforcement action over its stablecoin, BUSD, although that decision isn't final. /jlne.ws/3Z4h9uq

- The U.S. Security and Exchange Commission's warning shot on Binance's stablecoin over whether or not it is a security could offer a hint at what type of dollar-pegged tokens may draw regulatory scrutiny, critical information for other digital asset firms offering a less volatile way to trade crypto. Stablecoins, with a market valued over $137 billion according to CoinGecko, are digital tokens typically backed by traditional assets like the U.S. dollar or U.S. treasuries that are designed to hold a steady value. /jlne.ws/3kgdVFw

JP Morgan cracks down on traders' use of ChatGPT; JP Morgan has restricted traders' use of ChatGPT as employers grow increasingly nervous over sensitive data being exposed. JP Morgan is among investment banks to have placed temporary curbs around access to the chatbot tools. Accenture, the tech consultancy which has more than 700,000 workers, has also warned staff over exposing client information to ChatGPT's tools. /jlne.ws/3lZl9OE

Hong Kong to Establish Task Force to Help Develop Crypto Hub; Financial Secretary Paul Chan lays out plan in budget speech; City building out regulatory regime for virtual-asset sector;L Hong Kong will set up a task force to provide recommendations on how it can achieve a recently adopted goal of becoming a crypto hub. "Over the past few months, a large number of innovative enterprises with potential have been considering setting up business in Hong Kong," Financial Secretary Paul Chan said in his 2023-2024 fiscal year budget speech. /jlne.ws/3Y17C6A

OMFIF-DMI; Digital currency within 10 years; CBDCs sooner rather than later, say central banks; *OMFIF's 'Future of payments' survey found that two-thirds of central bank respondents expect to issue a CBDC in the next 10 years. Research into CBDCs has been accelerating in the past few years and several countries have already deployed their CBDC solutions, either as pilots or full-scale rollouts. These projects, though not necessarily perfect in their execution or adoption, have given watching central banks real-world projects to learn from.*

- Many questions remain about the form and structure CBDC designs will take but having live projects to analyse has given other central banks more confidence about their own plans. The survey also revealed that around 38% of respondents had become more inclined to issue a CBDC over the course of 2022.
- Click below to read the full article in the DMI annual 2023 (page 13). You may also be interested in an article by Michael Kanovitz, chief executive officer of Jurat, on effective crypto regulation on page 31.

Australia's recent announcement of a Token Mapping Consultation has generated much interest (and circumspection) in the crypto community. One of the main aims of the consultation from The Treasury's Crypto Policy Unit is to map out the existing regulatory framework against crypto products and services, their uses, and ecosystems. *By doing so, it hopes to inform future policy development and encourage innovation with appropriate regulatory oversight. The crypto industry is rapidly evolving and given the continued market adoption of various crypto assets, this consultation is certainly welcome.*

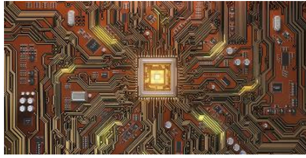
- Whilst it is termed a token mapping exercise, the paper initially assesses the ecosystem against a 'functional perimeter' which is intended to map facilities through which a person can (a) make financial investments, (b) manage financial risks or (c) make non-cash payments. Whilst certain inclusions and exclusions are mentioned, the "token mapping" seems to concentrate on a finance-related function. However, other concepts like record-keeping tokens, DAOs and even in-game crypto token items are also covered. One important outcome from this consultation is understanding whether reforms will be limited to products and services involving a 'functional perimeter' or whether a broader market will be captured.
- It will also be fundamental to consider regulations and frameworks in the context of a global market and audience. Tokens, and token systems, by their design involve participants from across the world, and such participants are often also anonymous. Many regulators have launched their own consultations with particular aims and priorities, but to truly "map" this, it cannot be done in a vacuum and there must be coordinated reviews, responses, standards, and protocols amongst regulators to ensure there continues to be a balanced regulatory environment whilst ensuring all stakeholders can benefit from an evolving technology.

- Feedback on the consultation is due 3 March 2023. The Treasury will propose a framework for custody and licensing for public comment in mid-2023 after reviewing feedback from this consultation.

Banking agencies release digital asset liquidity guidance; *On February 23rd, the Fed, OCC and FDIC released a joint statement on liquidity risks stemming from digital asset activities*.

- The statement is largely consistent with existing expectations for sound liquidity risk management, but it highlights key risks from crypto-assets and crypto-asset participants, and outlines effective liquidity risk management practices.
- Specifically, it warns that the stability of deposits placed by digital asset firms on behalf of customers is driven, not only by the behavior of the digital asset firm, but also by the behavior of the end customer and the dynamics of the digital asset market. It also states that deposits of stablecoin-related reserves can be susceptible to large and rapid outflows as a result of dislocations in digital asset markets. Further, it notes that liquidity risk may be further heightened in banks with funding bases that are highly concentrated in interconnected digital asset entities.
- To address these risks, the statement recommends that banks that use sources of funding from digital asset entities (1) understand the drivers of potential behavior of deposits and the extent to which they are susceptible to unpredictable volatility; (2) assess concentration and interconnectedness across deposits from digital asset entities; (3) incorporate digital asset liquidity risks into contingency funding planning, including liquidity stress tests; and (4) perform robust due diligence and ongoing monitoring of digital asset entities, including representations made to customers that could result in rapid outflows of deposits.
- The joint statement makes clear that if banks wish to transact with digital asset entities, regulators expect them to leverage the existing liquidity management framework while incorporating specific risks and attributes of digital assets. As we have seen with hedge funds, regulatory expectations for banks flow indirectly to their customers and counterparties - in this case, digital asset firms - with the intended effect of promoting greater safety, soundness and stability in the financial system.
- While the first three recommendations emphasize that existing requirements apply to banks' digital asset firm customers, banks will need sufficient expertise to adequately monitor the market and adjust their programs accordingly. The recommendation to perform due diligence and ongoing monitoring of these customers, however, is new and developing a program to do so will be time consuming and challenging for banks. For example, banks will need to create a framework to evaluate how digital asset customers are representing deposit account characteristics such as FDIC insurance to their end-customers, as this type of inaccurate representation could trigger large, unexpected outflows. Although bank regulators explain in the statement they are not creating any new requirements, they have repeatedly stated that banks must seek pre-approval before conducting digital asset activities, demonstrating these liquidity risk management practices will be an important prerequisite.

Quantum computing revolution approaches; ***Classical computing won't disappear, but new methods bring opportunities;*** by Gary Seabold 24 February 2023; *The era of quantum computing is coming more quickly than many realise. Both public and private sectors, particularly financial services, must ensure they are ready for the huge changes that the new technology will bring.*



- For decades, quantum computing has been viewed as a futuristic technology: it would change everything, if it ever moved from the fantastical to the practical. Even in recent years, despite billions of dollars in research investment and extensive media coverage, the field is sometimes dismissed by real-life decision-makers as a far-out pursuit for academics and theorists.
- However, new challenges, like climate change, novel diseases and the world's ever-growing population, have driven an increased need for agility, resiliency and accelerated digital maturity. With this acceleration, there will be soon a new era of computation. Quantum computing, as the heart of quantum-centric supercomputing, will dramatically impact how science and business evolve. By accelerating the discovery of solutions to big global challenges, quantum computing could unleash positive disruptions significantly more unexpected than technology waves of the past decades.
- Classical computer bits can store information as either a 0 or a 1. That the physical world maintains a fixed structure with defined states is in keeping with classical mechanics. But scientists have pushed into the quantum realm of subatomic particles and realised that matter takes on probabilistic states – different possible features in different conditions. The field of quantum physics emerged to explore and understand that phenomena. Quantum computing uses quantum physics to solve problems beyond the capabilities of classical computers.
- The power of quantum computing rests on two cornerstones of quantum mechanics: interference and entanglement. The principle of interference allows a quantum computer to cancel unwanted solutions and enhance correct solutions. Entanglement means the combined state of the qubits contains more information than the qubits do independently. These two principals have no classical analogy and modelling them on a classical computer would require massive resources. For example, representing the full complexity of a 100-qubit quantum computer would require more classical bits than there are atoms on earth.
- The building blocks of quantum computing are already emerging. IBM is running quantum computing systems on the cloud at an unprecedented scale, compilers and algorithms are rapidly advancing and communities of quantum-proficient talent are growing. The technology's applicability is no longer a theory, but a reality to be understood, strategized about and planned for.
- The implications of quantum computing for businesses and governments are colossal. Much of our information is stored and protected by encryptions that, though highly resilient to conventional cyberattack, will offer little protection against an attack by a quantum computer. There are opportunities as well as threats, however. The immense processing power quantum computing offers could yield remarkable results, offering new tools for analysis of data, which could revolutionise how portfolio management and risk analysis operations are performed.
- Quantum computing will not replace classical computing; it will extend and complement it. But even for the problems that quantum computers can solve better, we will still need classical computers. Because data input and output will continue to be classical,

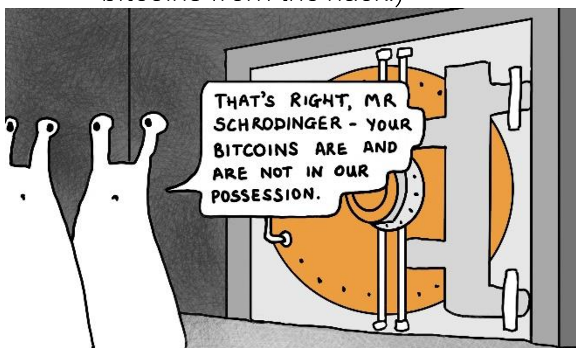
quantum computers and quantum programmes will require a combination of classical and quantum processing.

- IBM Quantum is continuing to push forward its technology roadmap to realise quantum computing and quantum-centric supercomputing. These advances will bring useful quantum computing to the world – and help solve some of the most pressing challenges humanity faces.
- *Gary Seybold, Associate Partner, Offering Management (Business Process Operations), IBM.*

If I Had A Quantum Computer, I'd Keep Quiet About It; How do you use your mad code cracking skills without alerting your targets? DAVID G.W. BIRCH

- Before we get on to Bitcoin, I want to take a few minutes of your time to tell you the story of the Zimmerman telegram, a story that is well known to military historians and computer security experts and for good reason.
- Share
- The story begins in World War I, when Britain wanted America to join the fight against the Axis of Edwardian Evil: Germany, the Austro-Hungarian empire and the Ottomans. In 1917, the Kaiser's ministers had come up with some interesting plans to extend the war on multiple fronts. They wanted to persuade inhabitants of the British (and French) colonies in the Middle East to launch a jihad against the colonial powers and they wanted Mexico to enter the war on the German side with the latter plan intended to divide a potential US war effort.
- (At this point, I cannot recommend historian Barbara Tuchman's 1966 account of the affair, "The Zimmermann Telegram", highly enough.)
- To execute this dastardly plot, the German Foreign Secretary, Arthur Zimmermann, sent a telegram to the German ambassador in Mexico, Heinrich von Eckardt. The telegram instructed the ambassador to approach the Mexican government with a proposal to form a military alliance against the United States. It specifically promised Mexico the land acquired and paid for by the United States after the US-Mexican War of 1846-48 if the Mexicans helped Germany to win the war. The German ambassador relayed the message, but the Mexican president declined the offer.
- Naturally, so sensitive a topic demanded an encrypted epistle, and it was duly dispatched after being encoded using the German top secret "0075" code. As it happened, "0075" was a code that the British had already cracked. Thus, the telegram was intercepted and decrypted quickly enough to get the gist of it to the British Naval Intelligence unit, Room 40. In next to no time, the decoded dynamite was on the desk of the Foreign Secretary Arthur Balfour, teutonic perfidy laid bare.
- Now, however, the British were faced with an interesting problem. How can you use intercepted information without revealing that there is a security flaw and that you have exploited it? Consider the options:
- If the British had complained to the Germans about trying to get Mexico into the war, then the Germans would know that the British had the key to their code and they would switch to another code that the British might not be able to break for months, missing much vital military intelligence along the way. What's more, the Americans would know that the British were tapping their incoming diplomatic traffic, but
- If they did not reveal the contents, they might miss the chance to bring America into the war.

- The British codebreaker's innovation solution was to leak the information in such a way as to make it look as if the leak had come from the Mexican telegraph company: since the German relay from Washington to Mexico used a different code, that the Americans already knew to be broken, this was entirely plausible.
- If you're wondering what happened, well despite strong anti-German (and anti-Mexican) feelings in the US, the telegram was believed to be fake news planted by the British to get America to join the war. This theory was bolstered by German and Mexican diplomats as well as the Hearst press empire. However, on March 29th, Zimmermann gave a speech confirming the text of the telegram. On April 2nd, President Wilson asked Congress to declare war on Germany, and on April 6th they complied.
- The point of this story is that if you have a means to decode highly secret information, you have to be very careful how you use that information, because if people know that you can decode their highly secret information, they will find a different way of protecting it.
- Decode And Win
- Why am I thinking about this? Well, the accountants Deloitte reckon that about four million Bitcoins could be stolen by a quantum computer. With Bitcoin at $20,000 or so, that means billions of dollars is up for grabs. It would therefore be well worth spending a few billion to build such a device if you are a criminal, well worth spending tens of billions or even hundreds of billions on such a device when Bitcoin has taken over and has become the need digital gold and each Bitcoin is worth like $1m each or something which is bound to happen I read about it on the internet.
- Upgrade to paid
- Let apply the lessons of the Zimmermann telegram in this case. Suppose that I had invented a quantum computer capable of looting Bitcoin at will. If I get hold of the Satoshi wallet and transfer a couple of billion dollars to myself, my cover will be blown. I'll have the Elliptic hellhounds on my tail and even if it takes years, they will track me down. Look at what happened to the billions hacked from the Bitfinex exchange in 2016: Last year the US Department of Justice seized $3.6bn and arrested Heather Morgan--aka "Razzlekhan"--and her husband Ilya Lichtenstein for attempting to launder 119,754 bitcoins from the hack.)



- Why am I thinking about this now? Well, it's because of the claim by Chinese researchers that they have found a way to break the RSA algorithm (on which much of the internet's security depends) using the current generation of quantum computers, years before the technology was expected to pose a threat. In the paper on "Factoring integers with sublinear resources on a superconducting quantum processor" the researchers says that they can break the 2048-bit RSA using a 372 quantum bits (qubits) computer.

- (IBM has already said that its 433-qubit Osprey system, the most powerful quantum computer to have been publicly unveiled, will be made available this year.)
- When I read this report, I had the same thought as Alexander Martin in The Record: The authors of the paper in question are affiliated with some of China's most prestigious universities, including several State Key Laboratories which receive direct funding and support from Beijing, and many observers have said that they expected such a breakthrough with such significant security implications would be classified by the Chinese authorities.
- (If the British government has already discovered such an algorithm, I'd hope that they would keep it to themselves for the time being and come up with some Zimmermann-style subterfuges to exploit the ability.)
- While security experts seem sceptical that this Chinese solution can scale, I could not help but notice that while The Patriot Act became law 45 days after the 9.11.01 terrorist attacks, The Quantum Computing Cybersecurity Preparedness Act ("Quantum Act") was signed within days of the Chinese paper being published. You can understand the fear, because while the Chinese claims may be exaggerated, there is no doubt that code-cracking quantum computers will happen.
- Professor John Martinis, who used to be the top scientist in the Google quantum computing team, says that a system with enough logical qubits to execute powerful algorithms that attack problems that are beyond the capability of classical supercomputers is about a decade away, If I come across a way to find prime factors in polynomial time using a quantum computer before then, I can assure you that won't read about it in my LinkedIn feed or here on Substack.

Sanctions

Announcement of the Price Cap Levels for Russian Refined Products; *The UK, in partnership with the G7 countries, Australia and the European Union, has already implemented a price cap on Russian crude oil trade by firms shipping oil to third countries. This cap was set at USD$60 per barrel, and came into effect on 5 December 2022.*

- It was also agreed that a price cap would come into effect for Russian refined oil products from 5 February 2023, and the UK and its price cap Coalition partners have agreed that this cap will be determined by categorisation of refined oil products as follows:
    - Products categorised as 'premium to crude' will be subject to the Premium to Crude price cap.
    - All other products are categorised as 'discount to crude' and will be subject to the Discount to Crude price cap.
- As with the 5 December oil price cap, OFSI has issued a General Licence to implement the caps for oil products. As with the existing price cap for oil, the level of both caps will be kept under review.
- Furthermore, as announced on Thursday (see OFSI blog) OFSI has issued a further wind-down General Licence for oil products. This will permit contracts to ship Russian oil products traded at a price above the relevant cap where the products were loaded before 5 February 2023, and are unloaded at the destination port by 1 April 2023.

- OFSI has released updated guidance on the Maritime Services Prohibition and the Oil Price Cap, which provides full detail of the implementation of the price caps, OFSI's approach to enforcement, and the requirements on involved persons. This has been reviewed and updated to reflect requests for clarification and additional details for refined oil products. Bespoke forms for required reporting, reporting suspected breaches, and specific license applications are available here. HM Treasury will organise teach-ins for interested stakeholders over the next few weeks.
- Any reporting or queries should be directed to oilpricecap.OFSI@hmtreasury.gov.uk.

2.3 Associated Services Ban; 2.3.1 Financial services, funds, and brokering services

- The regulations prohibit the provision of financial services, funds, or brokering services in pursuance of, or in connection with, an arrangement whose object or effect is the supply or delivery of oil and oil products by ship, from a place in Russia to a third country, or from one third country to another third country. The definitions of "brokering services", "funds" and "financial services" are the same as the existing definitions in legislation set out in regulation 21(1) of the regulations and sections 60(1) and 61(1) of the Sanctions and Anti-Money-Laundering Act 2018. These can be found in Annex A of this document

Table 2.A Products in scope of UK Maritime Transportation Ban

HS Heading	Product Description
2709	Petroleum oils and oils obtained from bituminous minerals, crude. Includes Clean Condensate
2710	Petroleum oils and oils obtained from bituminous minerals, other than crude; preparations not elsewhere specified or included, containing by weight 70% or more of petroleum oils or of oils obtained from bituminous minerals, these oils being the basic constituents of the preparations; waste oils. Includes HSFO, VGO, Kerosene.

- These headings align with the coverage of the EU's sixth and eighth package of sanctions, and the goods in scope of the US Determination. For goods which fall under HS heading 2710, the applicable price cap is determined by the categorisation of products (by HS sub-heading) as either 'premium to crude' or 'discount to crude'. Those classed as 'premium to crude' are subject to the Premium to Crude price cap, while all other products are classed as 'discount to crude' and are therefore subject to the Discount to Crude price cap.
- Products subject to the Premium to Crude price cap include gasoline, motor spirits, aviation spirits, motor fuel blend stocks, gasoil and diesel fuel, kerosene and kerosene-type jet fuel, and vacuum gas oil.

2.7 Involved Persons; 2.7.1 Definition of Involved Persons; An "involved person" means a person who is involved in either:

- the supply or delivery of oil or oil products; or
- the provision of financial services, funds, or brokering services relating to the supply or delivery of oil and oil products as defined in the regulations.
- The term "involved person" captures actors across the three tiers outlined in Chapter 5 who are involved in the supply or delivery of oil and oil products or the provision of financial services or funds or brokering services relating to the supply or delivery of oil and oil products
- A.1.2 Financial services, funds, and brokering services
- It is an offence to provide financial services, funds, or brokering services (see A.3-5) to anyone, anywhere in the world, who is transporting Russian oil or oil products by ship,

after the relevant date (5 December 2022 for Russian oil or 5 February 2023 for Russian oil products) from a place in Russia to a third country, or from one third country to another third country, if the oil or oil product has been purchased above the price cap.

EU agrees price caps on Russian oil products; Ambassadors to impose a $100-a-barrel cap on diesel and a $45 cap on low-end products

- EU member states have agreed on the level of price caps to be imposed on shipments of Russian refined oil products, which will come into effect on Sunday as part of a G7 effort to cut Moscow's export revenues. Ambassadors of the 27 EU states agreed at a meeting on Friday to limit the price of premium products such as diesel at $100 a barrel and that of low-end products including fuel oil at $45 a barrel.
- The caps will allow shipping companies carrying Russian oil products to access western insurance and financing only if they pay less than the prescribed level.
- The Swedish rotating presidency of the bloc said the agreement was important as it was "part of the continued response by EU and partners to the Russian war of aggression against Ukraine".
- More hawkish EU states including Poland and the Baltics were successful in demanding a review of the cap level every two months, according to two officials. Other G7 states including the US are less inclined to such a mechanism given the potential instability it could cause on energy markets, officials said.
- In the final agreement, ambassadors agreed to a first review by mid-March with the commission considering the impact of the cap both on the Russian budget and member states, according to a draft of the proposal seen by the Financial Times. It would also take account of its effect on the market "including possible turbulences", the document said.
- The cap compares with a current market price for diesel of about $110-$120 a barrel. High-quality refined fuels such as diesel and petrol are almost always more expensive than crude, which is trading near $80 a barrel, given the additional costs of refining and handling.
- But since the full-scale invasion of Ukraine diesel in particular has soared as Russia was Europe's largest external supplier of the fuel, while many European buyers have already turned away.
- The tightness in diesel markets has raised questions over whether EU buyers will be able to quickly replace the barrels they once got from Russia once sanctions create an embargo. The relatively small implied discount under the price cap for diesel is partly a reflection of concerns about tightness in the market globally, according to members of the G7 coalition.
- The $60-a-barrel price cap on Russian crude imposed by the EU in December also comes with a review every two months. Spearheaded by the US, it was agreed following similar pressure from central and eastern European capitals that argued that the level had to be adjusted regularly to keep reducing Russia's war coffers.
- A senior Treasury official from the US defended the crude oil price cap mechanism from criticism that it would do little to change Russian behaviour or damage its economy. "Our intent is not to crash the Russian economy. Our intent is to force the Kremlin to choose between propping up its economy and paying for their war," the official said. Meanwhile, oil prices had not risen following the embargo as some analysts predicted, the official said. "We've also seen positive signs that the price cap on oil is supporting our second goal of promoting stable energy [supply]," the Treasury official said, adding

that global oil prices were now lower than before the crude restrictions started in early December.
- One EU diplomat said that caps were a "well-balanced restrictive measure [that] will keep the price of oil and derived products low enough to reduce Russia's income while guaranteeing access for third countries". The debate between the EU's 27 capitals over the level of the cap was exacerbated by demands from some countries to also tighten trade sanctions against Belarus, Moscow's crucial ally and military supporter in the war. In a bid to reach an agreement on the price cap, the debate over Belarus sanctions has been shifted to a discussion later this month on a new package of sanctions against Russia, two officials said.
- EU reportedly plans vote on Russian oil price caps EU member states postponed a decision until Friday on the European Commission's proposed $100 per barrel price cap on Russian oil products and a $45 per barrel cap on discounted products, according to sources. Four EU members are calling for the caps to be set lower, but changing the price levels is unlikely since they are part of an agreement with the Group of Seven countries. Reuters

OFSI Webinar on commercial services; The Department for Business, Energy, and Industrial Strategy (BEIS) is hosting a webinar on **Tuesday 7 February at 11:00** to help industry understand recent changes to UK sanctions relating to commercial services trade with Russia. *The briefing is to assist organisations to stay up to date and understand how to comply with recent changes. The new measures expand the services export prohibitions to cover audit, architecture, engineering, advertising, and IT consultancy and design services.*
- Speakers will include representatives from BEIS, the Foreign, Commonwealth and Development Office (FCDO), the Department for International Trade (DIT) and the Department for Digital, Culture, Media and Sport (DCMS).
- The webinar will cover the following topics:
- Overview of new services trade sanctions measures: sectoral scope and activities
- Process for licensing and disclosures
- Q&A (answers will be provided to questions submitted in advance and, time permitting, a short slot may be offered to respond to questions submitted on the day via the event chat)
- The webinar will take place on **7 February at 11:00** and will be hosted on Microsoft Teams Live.
- **Register** via this Microsoft Form by **Monday 6 February at 15:00** to guarantee attendance. Questions may be submitted in advance via this form and the webinar will be hosted via Microsoft Teams Live.
- The government's existing guidance is summarised here: https://www.gov.uk/government/publications/russia-sanctions-guidance/russia-sanctions-guidance

Announcement of the Price Cap Levels for Russian Refined Products; *The UK, in partnership with the G7 countries, Australia and the European Union, has already implemented a price cap on Russian crude oil trade by firms shipping oil to third countries. This cap was set at USD$60 per barrel, and came into effect on 5 December 2022.*
- It was also agreed that a price cap would come into effect for Russian refined oil products from 5 February 2023, and the UK and its price cap Coalition partners have agreed that this cap will be determined by categorisation of refined oil products as follows:

  - Products categorised as 'premium to crude' will be subject to the Premium to Crude price cap.
  - All other products are categorised as 'discount to crude' and will be subject to the Discount to Crude price cap.
- As with the 5 December oil price cap, OFSI has issued a General Licence to implement the caps for oil products. As with the existing price cap for oil, the level of both caps will be kept under review.
- Furthermore, as announced on Thursday (see OFSI blog) OFSI has issued a further wind-down General Licence for oil products. This will permit contracts to ship Russian oil products traded at a price above the relevant cap where the products were loaded before 5 February 2023, and are unloaded at the destination port by 1 April 2023.
- OFSI has released updated guidance on the Maritime Services Prohibition and the Oil Price Cap, which provides full detail of the implementation of the price caps, OFSI's approach to enforcement, and the requirements on involved persons. This has been reviewed and updated to reflect requests for clarification and additional details for refined oil products. Bespoke forms for required reporting, reporting suspected breaches, and specific license applications are available here. HM Treasury will organise teach-ins for interested stakeholders over the next few weeks.
- Any reporting or queries should be directed to oilpricecap.OFSI@hmtreasury.gov.uk.

2.3 Associated Services Ban

2.3.1 Financial services, funds, and brokering services

The regulations prohibit the provision of financial services, funds, or brokering services in pursuance of, or in connection with, an arrangement whose object or effect is the supply or delivery of oil and oil products by ship, from a place in Russia to a third country, or from one third country to another third country. The definitions of "brokering services", "funds" and "financial services" are the same as the existing definitions in legislation set out in regulation 21(1) of the regulations and sections 60(1) and 61(1) of the Sanctions and Anti-Money-Laundering Act 2018. These can be found in Annex A of this document

Table 2.A Products in scope of UK Maritime Transportation Ban

HS Heading	Product Description
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2710	Petroleum oils and oils obtained from bituminous minerals, other than crude; preparations not elsewhere specified or included, containing by weight 70% or more of petroleum oils or of oils obtained from bituminous minerals, these oils being the basic constituents of the preparations; waste oils. Includes HSFO, VGO, Kerosene.

These headings align with the coverage of the EU's sixth and eighth package of sanctions, and the goods in scope of the US Determination. For goods which fall under HS heading 2710, the applicable price cap is determined by the categorisation of products (by HS sub-heading) as either 'premium to crude' or 'discount to crude'. Those classed as 'premium to crude' are subject to the Premium to Crude price cap, while all other products are classed as 'discount to crude' and are therefore subject to the Discount to Crude price cap.

Products subject to the Premium to Crude price cap include gasoline, motor spirits, aviation spirits, motor fuel blend stocks, gasoil and diesel fuel, kerosene and kerosene-type jet fuel, and vacuum gas oil.

2.7 Involved Persons

2.7.1 Definition of Involved Persons

An "involved person" means a person who is involved in either:

- the supply or delivery of oil or oil products; or
- the provision of financial services, funds, or brokering services relating to the supply or delivery of oil and oil products as defined in the regulations.

The term "involved person" captures actors across the three tiers outlined in Chapter 5 who are involved in the supply or delivery of oil and oil products or the provision of financial services or funds or brokering services relating to the supply or delivery of oil and oil products

A.1.2 Financial services, funds, and brokering services

It is an offence to provide financial services, funds, or brokering services (see A.3-5) to anyone, anywhere in the world, who is transporting Russian oil or oil products by ship, after the relevant date (5 December 2022 for Russian oil or 5 February 2023 for Russian oil products) from a place in Russia to a third country, or from one third country to another third country, if the oil or oil product has been purchased above the price cap.

CREDIT SUISSE: Credit Suisse loaned hundreds of millions of dollars to Abramovich's offshore companies, which used U.S. stocks as collateral, two new leaks reveal. The secretly-owned firms loaned each other massive sums that were mysteriously returned or written off, in what experts said could be a scheme to obscure the origin of the funds.

Glencore reportedly holds Russian aluminium in LME warehouse Sources say that 40,000 tonnes of Russian aluminium has been delivered off warrant to a London Metal Exchange warehouse in South Korea in October by commodity trader Glencore, though Glencore has declined to comment. LME decided in November not to ban Russian metal outright, and Glencore has a contract with Russian aluminium producer Rusal, which is not under sanctions. Reuters

OFSI; 28 entries have been amended under the ISIL (Da'esh) and Al-Qaida organisations financial sanctions regime and remain subject to an asset freeze.

- This follows an update to the UK Sanctions List, enacting the UN's decision made on 2 February 2023 to amend entries.
- Furthermore, 4 entries have also been corrected under the ISIL (Da'esh) and Al-Qaida organisations regime and remain subject to an asset freeze.

OFSI 15 entries have been added to the Russia financial sanctions regime. On 8 February 2023 the Foreign, Commonwealth and Development Office updated the UK Sanctions List on GOV.UK. This list provides details of those designated under regulations made under the Sanctions Act.

15 entries have been added to the Russia financial sanctions regime and are now subject to an asset freeze.

OFSI; 3 entries have been added to the Global Anti-Corruption financial sanctions regime. On 10 February 2023 the Foreign, Commonwealth and Development Office updated the UK Sanctions List on GOV.UK. This list provides details of those designated under regulations made under the Sanctions Act.
The following entries have been added to the Global Anti-Corruption financial sanctions regime and are now subject to an asset freeze:

- Vasil Kroumov Bozhkov (Group ID: 15737)
- Delyan Slavchev Peevski (Group ID: 15735)
- Ilko Dimitrov Zhelyazkov (Group ID: 15736)
- Furthermore, 2 entries have been corrected under the Cyber financial sanctions regime and remain subject to an asset freeze. The relevant notice can be found here.

New EU Sanctions Consolidated Sanctions List:

- PDF - v.1.0
- CSV - v.1.0
- CSV - v.1.1
- XML (Based on XSD) - v.1.1.
- XML (Based on XSD) - v.1.0.

7 entries have been added to the Cyber financial sanctions regime. *On 9 February 2023 the Foreign, Commonwealth and Development Office updated the UK Sanctions List on GOV.UK. This list provides details of those designated under regulations made under the Sanctions Act. The following individuals have been added to the Cyber financial sanctions regime and are now subject to an asset freeze:*

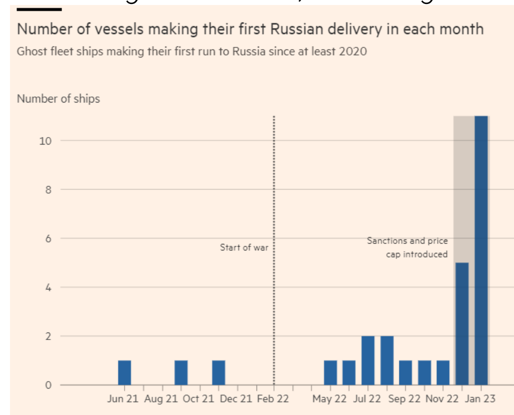
- Valentin Olegovich Karyagin (Group ID: 15738)
- Maksim Sergeevich Mikhailov (Group ID: 15739)
- Dmitry Pleshevskiy (Group ID: 15740)
- Mikhail Iskritskiy (Group ID: 15741)
- Vitaly Nikolayevich Kovalev (Group ID: 15742)
- Ivan Vasilyevich Vakhromeyev (Group ID: 15743)
- Valery Veniaminovich Sedletski (Group ID: 15744)
- OFSI, in partnership with other HM Government (HMG) organisations, has published guidance on sanctions and ransomware, which includes information on the impact of ransomware payments, cyber resilience, and HMG's approach to enforcement.
- Furthermore, the following entry has been corrected under the Russia financial sanctions regime and remains subject to an asset freeze. The notice can be found here.

G7's new petroleum price caps to degrade Russia's war campaign -Yellen; Western economies agreed new price caps on Friday on Russia's exports of oil products that U.S. Treasury Secretary Janet Yellen said would build on the crude oil cap set in December and further limit Russian oil revenues while keeping global energy markets supplied. The coalition imposing the measures, the Group of Seven economies, the EU and Australia, set the new price caps at $100 per barrel on products that trade at a premium to crude, principally diesel, and $45 per barrel for products that trade at a discount, such as fuel oil and naphtha. /jlne.ws/40xYzwo

ICE Announces Successful First Delivery of Russian-Free Barrels of ICE Gasoil; Intercontinental Exchange, Inc. (NYSE: ICE), a leading global provider of data, technology, and market infrastructure, announced the first delivery of Low Sulphur Gasoil futures since Russian oil was

excluded from the contract at the end of 2022. Following extensive consultation with market participants, and in line with sanctions preventing the delivery or export of Russian oil in the European Union (EU) which took effect from February 5, 2023, ICE changed the methodology for Low Sulphur Gasoil futures from previously delivering diesel from any origin, to deliver diesel that does not include any originating from Russia. ICE Gasoil is the global benchmark for refined oil products. /jlne.ws/3YikTIU

Ghost fleet: *Sanctions imposed by the EU, UK and US on Russia's oil exports have seen tankers from Iran's "ghost fleet" — previously used to circumvent UN sanctions against Tehran — switch to working for Moscow, according to a Financial Times investigation.*



iPhones still available in Russia; *There is more evidence that western sanctions are not achieving their stated goal - to deprive Vladimir Putin of the financial means to wage war. As it turns out, sanctions are also missing their secondary goal, to create political pressure on Putin from his own luxury-goods deprived population.*

- Die Welt has a terrific report from Moscow that shows that virtually all western luxury goods are available not through official channels, but through a highly efficient grey market. This list of goods includes iPhones and Mercedes-Benz cars, despite the fact that both manufacturers are no longer supplying their goods to Russia and have closed their local operations.
- This is how Die Welt described the transaction chain for a luxury car: *"A car is bought in Dubai and transported by ferry to Iran, then across the Caspian Sea to Kazakhstan. There it is registered in the name of a fictitious local buyer, who then sells it on to Russians and has it rolled across the duty-free Russian border by a car carrier."*
- This is a long chain with a lot of middlemen, who all make money from the transactions. For iPhones, the chains are simpler. They get shipped in small parcels from Kazakhstan. The problem for Russian buyers of western goods is not availability but price. Imported sanctioned goods are more expensive, in some cases double the original price. It has become a fashion statement in Moscow to wear something, or own something, that is on the sanctioned list: *Sankzionka,* as the Russians refer to goods on the sanction list.
- The Russian government is officially allowing those grey imports. The volume of those imports has been reportedly around €20bn in 2022, according to Russia's ministry of trade. Kazakhstan is responsible for 18% of all imported cars, despite the fact that the country has no car industry of its own.
- Another channel is through long-distance commuters, for example between Moscow and Dubai. They buy goods while abroad and take them home in large suitcases and

boxes. A number of Russians are also allowed to travel to Europe and the US, for example people with a dual nationality. Most of these commuter shoppers would buy goods on order. Russia's largest classified advertisement portal has a popular section *Goods from Europe*, often with an extra charge of only €15 per delivery. Apart from Dubai, Turkey is another source of western goods.

- The economic sanctions have, of course, material effects. On us. And on international supply routes. China's Belt and Road infrastructure plans are effective suspended. The Northern route, through Russia and Belarus, suffers from the collateral effect of western sanctions. The southern route, through Turkey, is still not operational.
- Now that the relationship between China and the US has entered deep-freeze, we can consider the China-Russia relationship to be the most important relationship on the Eurasian continent. Russia is only a small economy, but it is still a large regional power.

OFSI has updated General Licence INT/2023/2711256 pertaining to humanitarian activity in relation to earthquake relief efforts in Syria and Turkey. ; *The General Licence took effect from **11:59PM on 15 February 2023** and expires at 11:59PM on 15 August 2023.*

- The General Licence has been updated to clarify that the permission does not allow the use of economic resources owned, held or controlled by a Designated Person except where a Designated Person has received funds, goods or services in exchange for those economic resources from a Relevant Person to perform Relevant Activities.
- Any persons intending to use General Licence INT/2023/2711256 should consult the Licence for full details of the permissions and usage requirements along with the General Guidance.

EU Consolidated Sanctions List:

- PDF - v.1.0
- CSV - v.1.0
- CSV - v.1.1
- XML (Based on XSD) - v.1.1
- XML (Based on XSD) - v.1.0

HMRC; 92 entries added to the Russia regime; *92 entries have been added, and 1 entry amended, under the Russia financial sanctions regime.*

- On 24 February 2023 the Foreign, Commonwealth and Development Office updated the UK Sanctions List on GOV.UK. This list provides details of those designated under regulations made under the Sanctions Act.
- 92 entries have been added to the Russia financial sanctions regime and are now subject to an asset freeze.
- Furthermore, the following entry has been amended under the Russia financial sanctions regime and remains subject to an asset freeze.
- Nigina Zairova (Group ID: 15274)

UK Freezes Assets Of 4 More Russian Banks; The U.K. government on Friday announced sanctions against four more Russian banks as part of a larger, internationally coordinated sanctions and trade measures package. Read full article »

EU Consolidated Sanctions List :

- PDF - v.1.0
- CSV - v.1.0
- CSV - v.1.1
- XML (Based on XSD) - v.1.1.
- XML (Based on XSD) - v.1.0.

On 20 February 2023 the Foreign, Commonwealth and Development Office updated the UK Sanctions List on GOV.UK. This list provides details of those designated under regulations made under the Sanctions Act. *The following entries have been added to the Iran (Human Rights) financial sanctions regime and are now subject to an asset freeze:*

- Parviz Absalan (Group ID: 15749)
- Musa al-Hosseini (Group ID: 15745)
- Hassan Asgari (Group ID: 15752)
- Morteza Barati (Group ID: 15747)
- Amanollah Garshasbi (Group ID: 15750)
- Mohammad Karami (Group ID: 15751)
- Hadi Mansouri (Group ID: 15746)
- Mohammad Taghi Osanloo (Group ID: 15748)

Treasury announces more Russia sanctions. On February 24th, Treasury's Office of Foreign Assets Control announced new sanctions on Russia's metals and mining sector as well as 22 individuals and 83 entities involved in Russia's financial services sector, sanctions evasion activities, arms dealing and military supply chain.

US, allies plan another round of sanctions on Russia The US and other Western allies will add new sanctions on Russia and act against companies and individuals that are helping the country circumvent the current sanctions. "We will force those that fail to implement our sanctions and export controls to choose between their economic ties with our coalition of countries - representing more than half of the world's GDP - or providing material support to Russia, an economy that is becoming more isolated every day," Deputy US Treasury Secretary Wally Adeyemo said. On Tuesday, 12 EU member states urged the bloc to crack down on companies and outside jurisdictions that are helping Russia avoid sanctions. Reuters The Wall Street Journal

Sanctions police; *What happens if you or your company is placed under EU sanctions?*

- Well, the outcome varies quite a lot depending on which member state you ask. Ending that patchwork approach to sanctions implementation is the goal of the Netherlands, which has a new proposal: it wants to set up an EU "sanctions headquarters" in Brussels, to oversee implementation of the measures. Context: While the EU has passed nine packages of sanctions against Russia since its invasion of Ukraine last February (with a tenth coming this week), enforcement has been uneven.
- The European Commission proposes measures, which take force if approved by all EU capitals, but implementation is the job of member state national authorities. Wopke Hoekstra, the Dutch foreign minister who announced the plan yesterday, said the proposed body would "pool information and resources on effectiveness and evasion" and "do much more to fight circumvention". At least 10 member states, including the four largest — Germany, France, Italy, and Spain — were on board with a proposal paper

circulated on the idea, Hoekstra said, while also acknowledging that it could take some heavy lifting to get all 27 to agree. For many British and American officials, who have their own sanctions agency, it's long overdue. Many express exasperation at the lack of an EU centralised body with the power to ensure sanctions enforcement — especially given the glut of measures passed against Moscow this past 12 months.

- The idea is not totally new. Mairead McGuinness, EU financial services commissioner, told the FT last July that officials were discussing the creation of a sanctions authority to ensure more consistent enforcement of penalties Hoekstra described the Russia sanctions formation process as "like no man's land, learning from doing. We need to take these lessons . . . and become much more effective in applying the sanctions toolbox". "We need to further solidify this approach, we need to make sure that we are fit for the next phase and that more generally speaking, this will not be the last time that, the EU will feel it needs to apply sanctions," Hoekstra added.

Conduct / Enforcement / Reporting

How you log in to FCA systems is changing; *We have introduced multi-factor authentication to strengthen how you log into our systems and to further protect and control access to our data.*

- You now need to enter a one-time passcode every time you log into Connect, Reg Data, Online Invoicing, Shared Intelligence Service (SIS) and, from March, the Electronic Submission System (ESS).
- You'll be prompted to register and turn on multi-factor authentication when you log in. See our website for more information and resources.

Optiver Lobbying Comment: Not just PFOF: Another anti-competitive threat to European markets; *Payment for order flow is starting to attract real attention, but we think there's a more insidious threat to retail investors out there. It's the preferential market-making arrangements prevalent in countries like Germany. We encourage authorities to act now to rein in these practices*.

- Levelling the playing field for retail investors is an issue that's finally starting to galvanize European lawmakers. Authorities have recently turned their attention to regulating payment-for-order-flow (PFOF), with European lawmakers debating ways to limit or ban the practice as part of the Markets in Financial Instruments Regulation (MiFIR).
- But for all the attention being paid to PFOF, there's a more insidious threat to investor fairness that's not getting nearly as much airtime as it should. We're referring to the preferential market-making arrangements found throughout Europe but that are particularly prevalent in Germany.
- While PFOF can pose conflicts of interest, retail trading models in countries like Germany – which we highlighted in a January 2022 paper – are far more concerning. Regulators should act now to rein in these practices.
- The way this model works is that retail brokers send all or most of their customer orders to trading venues with one market-maker per instrument or product class. In return, the market-maker, often affiliated with the exchange, pays a per-order fee to the retail brokers.

- To understand how these arrangements rose to prominence, it helps to go back to early 2020, when pandemic lockdowns were fuelling waves of activity from retail investors. Alongside the rise of retail trading was a contemporaneous boom in trading apps giving easier and cheaper access to markets.
- Some of these new entrants use PFOF as a way to supplement revenues. In the US, PFOF represents a large chunk of these brokers' income. In countries like Germany, that revenue flows to brokers via the arrangements described above.

- Restricting access; The venues in question are regulated as multilateral exchanges but have rulebooks and policies that effectively restrict access to competing liquidity providers. One of the largest German retail venues, for example, prohibits non-specialists from deploying algorithmic or market-making strategies.
- In our view, the result is a market that behaves less like a multilateral exchange and more like a systematic internaliser (primarily used by banks to transact proprietary liquidity against client orders). These single market-maker venues also use a slimmed-down settlement process, which strips out a chunk of post-trade costs.
- Taken together, it's easy to see why these features make single market-maker venues a compelling commercial proposition for retail brokers. But the inherent conflicts in these models mean retail customers may be routing to venues that maximise their profits rather than seeking the best possible price for their orders.
- A February 2022 study from the Dutch AFM showed that one venue relying on a single market maker model delivered worse prices more than 70% of the time when compared with the listing market.
- Missed opportunity; To date, EU regulators have largely declined to address these models. The European Securities and Markets Authority failed to consider the structure of single market maker exchanges in its recent trading-venue perimeter investigation. Meanwhile, the MiFIR review is currently pursuing a narrow focus on US-style PFOF.
- The MiFIR text agreed by the Council of the European Union in December does not address the single market-maker model and allows member states to permit PFOF for domestic customer orders.
- The onus now lies with the European Parliament, which also has a say in the final MiFIR text.

- Despite some initial encouragement, MEPs appear unlikely to ban brokers from having preferential intermediary relationships.
- To us, that's a missed opportunity. While EU regulatory negotiations are notoriously fraught, the MiFIR review provides a window for tackling these problematic arrangements to ensure safeguards are put in place to foster competition and provide better outcomes for individual investors.
- Our paper on stimulating retail investor activity in Europe.
- We looked at some retail trading models in the region that are working.
- The Dutch AFM study on execution quality in trading venues.
- Our deep dive on PFOF in the US options market.

FCA: Respond to our request for information about Appointed Representatives (ARs); *In December 2022 we sent a mandatory Section 165 (S165) request to principal firms. This request reflects new rules requiring principals to provide more information about their Appointed Representatives (ARs) and strengthens the responsibilities and expectations of principals.*

- Principal firms with ARs must respond to this request by **28 February 2023**.
- We have provided S165 guidance for principal firms to help you complete the request.

FCA Primary Market Bulletin 43; *We have published the 43rd edition of the Primary Market Bulletin in which we:*

- Highlighted the launch of multi-factor authentication for FCA systems (including the Electronic Submission System) to strengthen how firms and others log into our systems and to further protect and control access to our data.
- Taken the opportunity to remind third country issuers of the equivalence of non-UK regimes and the financial reporting rules (DTR 4) exemption. In particular that we deem Generally Accepted Accounting Principles of the People's Republic of China (Chinese GAAP) to be equivalent.
- Reminded stakeholders of the 24 February 2023 deadline for commenting on our digital reporting consultation CP23/2.

Smooth start for CFTC's re-jigged swap reporting rules; *No problems yet, but some warn of potential pitfalls ahead with package trades and margin reporting.*

- The US Commodity Future Trading Commission's updated swaps data reporting and record-keeping rules went live on December 5 without any major complications, market participants report – though some experts say it will take months for a full picture of the rollout to emerge. "What we've been hearing from the market is, overall, smooth sailing," says Leo Labeis, chief executive of regulatory reporting firm Regnosys. "But I think, typically, you need to wait three to six months, and start to look into the data and start drawing conclusions on how successful the rollout is and have some initial perception of what the data quality and other new reporting requirements is.
- It's typically not something that you can do the day after the go-live." The compliance deadline for the re-written rules was delayed by more than six months, from May 25, after the International Swaps and Derivatives Association (Isda) and three swap data repositories (SDRs) – Ice, CME and DTCC – wrote to the CFTC asking for an extension. Although the rule changes were published in November 2020, the final technical specifications were only released in September 2021, which the industry argued did not allow enough time for them to be implemented and tested ahead of the original deadline. An IHS Markit survey in December 2021 found most firms were only just beginning to prepare to comply, or had not started at all. Since then, many smaller firms "have

invested the time and energy and money in this", says Sudhir Jain, managing director at Patomak Global Partners, a risk management consulting firm in Washington, DC. "And it seems like they have the right processes to get it done right."

- Others say it is still too early to assess the state of compliance. "I think it's going to be the usual mixed bag where a lot of the firms will be in a really good place and there'll be a few of the firms running a bit behind and not where they should be, says Alan McIntyre, a senior regulatory reporting specialist at fintech Kaizen Reporting. "But I'm going to be uncharacteristically upbeat for a Scotsman and say I think it's going to go quite well." McIntyre identified some potential problems that may rear their head in the coming weeks and months, including the reporting of package trades and collateral requirements as well as the short timeframe for correcting errors.
- Escape from Emir? Not so fast, swaps users The rewrite introduces eight new fields for the reporting of package trades, which he says have been the subject of much discussion at trade associations as to whether the package should be reported as one trade, or the components reported separately. Votes on this at the associations have revealed sharp divisions, McIntyre says.
- He also points out that firms have only seven days to fix errors or omissions in the reporting of trades. "That's a really tough time timeframe, your investigation could take more than seven days easily," he says. "And if they can't fix it within the seven days, they need to notify the CFTC in writing about what the issue is and why they couldn't fix it." And he singled out the collateral reporting requirement in the CFTC rewrite as a possible problem area. "This is brand new for US firms," says McIntyre. "And there's a well-documented issue roundabout collateral reporting, which is that the trading systems quite often don't talk to the collateral systems. So you're trying to collect data from two different places and tie them together in order to report them, so collateral is probably quite, quite tricky."
- Generally speaking, McIntyre says the rewrite still leaves a lot for firms to figure out. "There are a lot of fields that look optional," he says. "But optional doesn't mean optional. It's a banana skin, there for you to slip up on, because optional means it's required if applicable." There are a lot of fields that look optional. But optional doesn't mean optional. It's a banana skin, there for you to slip up on, because optional means it's required if applicable Alan McIntyre, Kaizen Reporting More regulatory reporting changes are on the way, with the introduction of the unique product identifier (UPI) and the International Organization for Standardization's (ISO) 20022 standard for payment messaging expected in late 2023.
- The UPI will assign a unique code to each distinct over-the-counter derivative product, allowing regulators to identify economically similar products traded in different markets. "The same product could be marked with the same ID, it doesn't matter if it has been traded in the US, Europe or Asia," says Jain of the UPI. "So what I call a swap you would also call as well." ISO 20022 effectively mandates a kind of data format for how trades need to be reported. "Here the challenge is to effectively map the way in which trades have been reported so far," says Labeis at Regnosys. When the standard is adopted, reporting specifications will be standardised across trade repositories. "Everybody will have to follow exactly the same model for reporting the data," Labeis says.

So, there has been significant focus on post-trade transparency (PTT) reporting in the last year by both the FCA and ESMA. *Since the foundations of MiFID II were put in place in 2018, the main area of consternation has been RTS 2 non-equities (rather than the vanilla RTS 1 equities).*

Leading up to go-live, the industry had been clear that bracketing all non-equities into one RTS wouldn't work. If we could start again, segregating out OTC derivatives from bonds and the other asset classes would be essential. Five years on, this debate still painfully rumbles on.

- What we are now seeing post-Brexit, is an interesting mix of divergence and convergence from the UK and EU regulators, with a common debate around liquidity vs transparency.
- ESMA issues positive opinion on amended RTS 1 and 2
- ESMA loves to share an update just before a holiday season and so it did just before Christmas 2022, confirming its support for the European Commission's proposed amendments to the regulatory technical standards on RTS 1 and RTS 2. The amendments are an attempt to establish increased transparency, strengthen data integrity and availability, and create a level playing field. However, it should be noted that this was the same mandate and message used more than five years ago when MiFID II went live in January 2018.
- So, is anything actually changing? And is ESMA's approach in line with the potential changes announced by the FCA in its post-Brexit consultation paper earlier last year?
- Liquidity vs transparency
- Liquidity vs transparency, as mentioned earlier, is still the burning argument. By increasing transparency, will this improve liquidity? A consolidated tape has been proposed since 2014 as consolidated tape providers (CTPs) were listed amongst approved publication arrangements (APAs) and approved reporting mechanisms (ARMs) as data reporting service providers (DRSPs), but none have materialised to date. It's complex. The industry sees shares and bonds in scope for consolidation, but the complexity of OTC derivatives is still a derided topic, with trade associations like ISDA at the forefront of lobbying what members are saying. Is a derivatives tape needed? There's also the terminology of MiFIR Article 13 and 'reasonable commercial basis'. How do the exchanges and APAs feel about this when data sales are a big revenue driver for them?
- Dark pools/trading
- Limitations on dark trading and moving to a single volume cap have been discussed and in practice for a while. But ESMA's latest update demonstrates how it is diverging from the UK. ESMA is trying to increase transparency with the aim of encouraging trading on lit markets, by keeping the cap in place, whereas the UK is trying to increase liquidity by reducing these restrictions and pulling back the liquidity that was lost when the UK exited the EU.
- Clarity on transparency fields
- Clarity on transparency fields is welcomed although the somewhat ambiguous 'price', 'quantity' and 'notional amount' are not always relevant, depending on the asset class being traded. More clarity is required on defining non-price forming transactions and deferrals aside, however it will be interesting to see how 2023 plays out.
- FCA's update on MiFIR transparency.
- ESMA's opinion still needs to be negotiated through the European Parliament and it is likely the new 'Manual' described in the guidance, will replace or co-exist with the transparency Q&A, whereas in the UK, HM Treasury has given the FCA the power to change the rules accordingly.
- With the FCA, we know the share & derivatives trading obligations (STO & DTO) have to change as the statements from the respective articles 23 and 28 in the regulation no

longer apply now the UK has segregated. Traded on a Trading Venue (ToTV) is questionable, but the biggest draw may be the delineation of the systematic internaliser (SI) regime from the reporting responsibility. It seems that this responsibility will be at entity level which still brings uncertainty around communication of status between SI and the Non-SIs and buy-side. A central evergreen source is needed, something like Smartstream RDU's SI register which was made available in preparation for 2018. This was crucial to market participants and APAs alike on the identification of who has the publication obligation, given RTS 1 and 2 post-trade transparency reporting is single-sided.

- Though trying to achieve extra transparency, the regulators need to keep one eye on creating undue risk in the market to those that are providing the much-needed liquidity. On the UK side, there is mention of change in deferral flags, providing more precise information and less ambiguity, but caution should persist. RTS 1 and 2's goals were OTC price transparency, level playing fields, and encouraging investor confidence, whilst reducing investor risk and allowing informed investment decisions for all. If the FCA and ESMA keep this in mind as 2023 progresses, taking on the feedback from the industry, the battle of liquidity vs transparency could harmonise into achieving both, a match made in heaven!

German Court Won't Consider Claim Of Cum-Ex Judges' Bias; Germany's high court won't hear a case brought by an individual convicted of cum-ex crimes in cross-border share trading who claimed that the judges hearing his case were biased, the court said Friday. 1 document attached | Read full article »

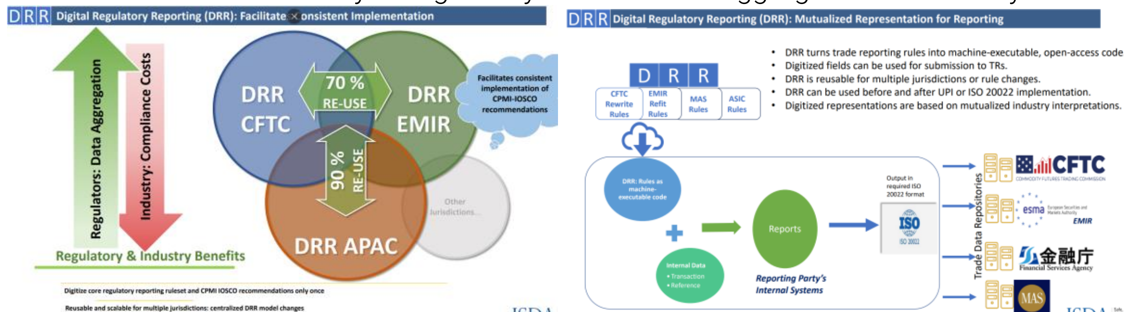
FCA - Significant SYSC definition (solo-regulated firms); *Cast your mind back to October 2022 SMCR+ View where we discussed the FCA's consultation on the definition of "Significant SYSC firm" as the FCA had caught a number of firms not previously subject to the Significant IFPRU firm definition and therefore had subjected them to additional regulatory obligations, including Enhanced firm status under the SMCR.*

- The FCA has now published its Handbook Notice 106 which confirms changes made to the rules (effective 27 January 2023) so that firms captured by the Significant SYSC firm definition will only be Enhanced firms under the SMCR if they would (pre-IFPR) have been classified as both IFPRU investment firms and Significant IFPRU firms under previous FCA rules.
- However, as ever, there is a wrinkle which is that, despite industry feedback to the contrary, this is as far as the changes go. This means that, regardless of whether or not they were previously IFPRU investment firms, all firms that fall within the scope of the definition of a Significant SYSC firm (for example because their annual revenues from regulated activities exceed £160 million) will be subject to the rule that places strict limits on the number of directorships that can be held by individual members of their governing body.
- This could, in particular, have ramifications in the private equity and venture capital industries, to the extent that members of the relevant firm's governing body hold multiple portfolio company directorships. It is possible to apply to the FCA for a waiver from the directorship restrictions for specific individuals.

DRR:

- Facilitates consistent implementation of the CPMI-IOSCO recommendations across multiple jurisdictions.
- Reduces inconsistencies between the way individual firms interpret and build rules.

- Time, effort, cost needed by industry to build to new or amended reporting rules is reduced.
- Improves the quality of data reported to TRs.
- Facilitates the ability of regulatory authorities to aggregate data to analyze.



ASIC to expand enforcement focus areas in coming year; *The Australian Securities and Investments Commission (ASIC) has [issued](#) a warning to businesses informing them of its plans to target greenwashing, predatory lending, and misleading insurance pricing promises in 2023, as part of a continuing focus on protecting consumers from financial harm.*

- The warning coincides with the release of ASIC's latest enforcement and regulatory report (Report 757), which outlines court-based actions against misconduct as a result of ASIC's investigations, its work to protect consumers and investors, and its increased focus on market integrity and sustainable finance. The report also sets out ASIC's 2023 enforcement priorities and includes a regulatory developments timetable to inform its stakeholders of proposed timeframes for ASIC's regulatory actions. In particular, the timetable is intended to help industry to better anticipate when ASIC will issue draft or final guidance, or the making of a legislative instrument.
- Amongst other things, ASIC plans to focus on enforcement activities targeting sustainable finance practices and disclosure of climate risks, financial scams, cyber and operational resilience, and investor harms involving cryptoassets.

Crypto assets – Call for Evidence and the SMCR play; *On 1 February 2023, HM Treasury published a long-awaited consultation and call for evidence on the future financial services regulatory regime for cryptoassets in the UK.*

- You can find a full summary in a special edition of Crypto View, but the high level takeaway is that HM Treasury are proposing to include cryptoassets as specified investments, and so require firms to be authorised under Part 4A of FSMA. By requiring a Part 4A permission to carry out cryptoasset activities the question as to whether cryptoasset firms would be brought within scope of the SMCR naturally arises.
- While the consultation does state that the FCA will consider whether to update the Senior Management Arrangements, Systems and Controls sourcebook (SYSC) and other financial crime rules to apply to new cryptoasset activities, it does not confirm whether firms will be subject to the SMCR.
- However, we would be surprised if in the long run, and in line with other changes to the SMCR regime under the Edinburgh Reforms, there won't be increased oversight of the Senior Managers of cryptoasset firms by the FCA.

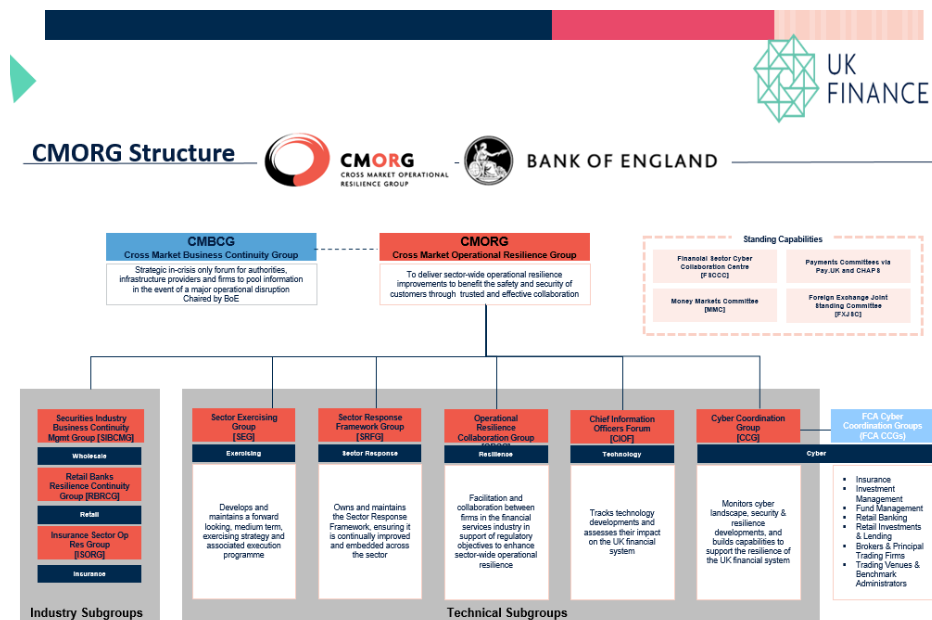
FCA - Speech on building better foundations in Artificial Intelligence (AI); *Coming hot on the heels of a number of speeches by the FCA on AI and governance (see our November edition of SMCR+ View), the FCA has published a speech by its Chief Data, Information and Intelligence Officer, which links the role of AI governance to obtaining DEI outcomes.*

- The speech notes that one of the key findings from the recent FCA/PRA survey on the use of machine learning in financial services (well worth a read in its own right) is that data bias and data representativeness were identified as the biggest risks to consumers. While acknowledging that one of the most significant open questions in financial services is whether AI can be managed through the existing regulatory regime, it seems the FCA already has the answer: the SMCR.
- This reaffirms the views expressed in the speeches at the end of last year by the FCA that the SMCR gives it the right framework to respond to AI and to address the DEI-related risks that its use entails.
- In particular, the FCA highlights the role of governance in addressing DEI-related risks in the use of AI, observing that when developing AI models, it matters who's 'in the room'. Effective governance and risk management in financial services firms using AI requires establishing rules, controls, and policies across the AI lifecycle. Good governance, though, must be complemented by a healthy organisational culture, which helps cultivate an ethical and responsible environment at all stages of the AI lifecycle, from idea, to design, to testing and deployment, and to continuous model evaluation.
- The SMCR framework creates incentives to collect data to measure the impact of technology on different demographics, and the FCA emphasises that this is important for linking Senior Managers' objectives to DEI outcomes.

If you have any questions please contact Minesh Tanna (Partner) and Angus Brown (Supervising Associate).

PRA and FCA - Letter to SMF responsible for cyber on CBEST thematic findings; This joint letter is addressed to the SMF with the responsibility for cyber (often an SMF 24), and shares the FCA and PRA's thematic findings from the latest annual cycle of CBEST assessments (testing which focusses on an organisation's security controls and capabilities when faced with a simulated cyber-attack). SMFs with responsibility for cyber should take into account the findings in order to identify similar potential weaknesses in their firms, raise awareness to their firms' senior executive team (as required), and use the findings to inform their work on their risk and internal audit functions.

- It is worth noting that the regulators may use their findings to structure future supervisory interaction and to understand the engagement with senior executives, risk, and audit functions on issues identified within firms as in need of remediation.



FCA - DP23/1 on finance for positive sustainable change; *DP23/1 explores how firms' sustainability related governance arrangements can help in driving positive sustainable change. There is a lot on culture and the importance of the Board and senior leaders in articulating and delivering a positive, inclusive culture where there is buy-in from employees. Not much of this section is 'new' but the FCA do ask stakeholders whether, beyond the FCA's ongoing work on D&I and the Consumer Duty, they should consider setting regulatory expectations or guidance on how firms' culture and behaviours can support positive sustainable change. It's a long paper, worthy of a read but here are some other SMCR+ points to note:*

- The FCA suggest that firms should be clear which roles at the firm are responsible for driving change and ensuring the firms' organisation is aligned with its commitments, especially in relation to ESG including climate transition, biodiversity, human rights, health and safety, D&I and fair pay. The FCA hasn't gone as far as creating ad hoc responsibilities that must be allocated (aside from the quasi-prescribed responsibility for identifying and managing financial risks from climate change for dual-regulated firms, which isn't new and typically sits with the CRO (SMF 4) or CEO (SMF 1)), but this is food for thought for firms (particularly dual regulated and Enhanced firms) as to how they allocate responsibilities for these matters currently and in the future as this area and their engagement with it evolves.
- In particular, the FCA still expects firms to consider who is responsible and accountable for the delivery of climate or sustainability objectives for solo-regulated firms. The FCA have asked stakeholders whether they should provide additional regulatory expectations or guidance to enhance individual ownership and responsibility for sustainability-related matters, and whether they should set new regulatory expectations or guidance on senior management responsibilities for a firm's sustainability-related strategy, including the delivery of the firm's climate transition plan. They've also asked which existing SMF(s) would be the most suitable to assume these responsibilities.
- In the case of climate in particular, which the FCA state is widely accepted as a financial risk to many firms, they consider it reasonable that CEOs, CROs and other appropriate

members of senior management can already credibly articulate how climate-related risks and opportunities are identified and managed within their firm. It would be worth ensuring that these senior executives are au fait with this should the FCA ask questions in the future.
- Board members with a background in or expertise in sustainability-related matters may assist in ensuring that the Board is collectively suitable and able to effectively lead and challenge the firm on its sustainability-related risks, opportunities and ambitions. The FCA have asked whether they should consider setting any regulatory expectations or guidance in this area and, if so, what should be the scope of such expectations.
- The FCA wants to see firms being appropriately equipped with the relevant skills and expertise, and firms should ensure they have adequate training in place to ensure sustainability objectives can be met. There are questions around whether there is a need for the FCA to articulate additional training and competence expectations in existing rules or guidance.
- We haven't the space to go into all the detail here but there is also a section on remuneration and incentive plans and the FCA have asked a couple of questions on what matters firms should take into consideration when designing remuneration and incentive plans linked to their sustainability-related objectives and whether they should issue further guidance on this - we are sure this is something firms will have a lot to say on!
- The FCA are asking for comments by 10 May 2023 and the FCA have said feedback will help them consider what direction their future regulatory approach should take and proportionality (which we know will be critical to many firms). There are a lot of big questions being asked by the FCA and we expect firms will have strong views. This topic also features heavily in our global legal and business outlook for 2023, and we will have a session that looks at the role of governance across ESG and for fast growth financial firms.

The FCA Consumer Duty is coming into force in July 2023. It represents a 'paradigm shift' in the FCA's expectations of firms, increasing the current level of consumer protection in the retail financial services markets. *At first glance, it seems that wholesale firms, such as banks, wholesale brokers, securities services firms or alternative asset managers, that do not interact directly with retail consumers may not need to take any action. However, through various updates the FCA is signalling that wholesale firms do need to review the requirements and reach a conclusion to validate the degree to which Consumer Duty will apply to their suite of products or services.*

- Consumer Duty — a summary
- The Consumer Duty introduces a new FCA Principle for firms — that a firm must act to deliver good outcomes for retail customers. Underneath the principle there are three overarching cross cutting rules — a firm must:
  - Act in good faith towards customers
  - Avoid foreseeable harm to customers.
  - Enable and support customers to pursue their financial objectives.
- And then there are four outcomes which represent the key elements of the firm-customer relationship where firms will need to capture specific, granular evidence they are delivering good outcomes:

1. *Products and services*
2. *Price and value*
3. *Consumer understanding*

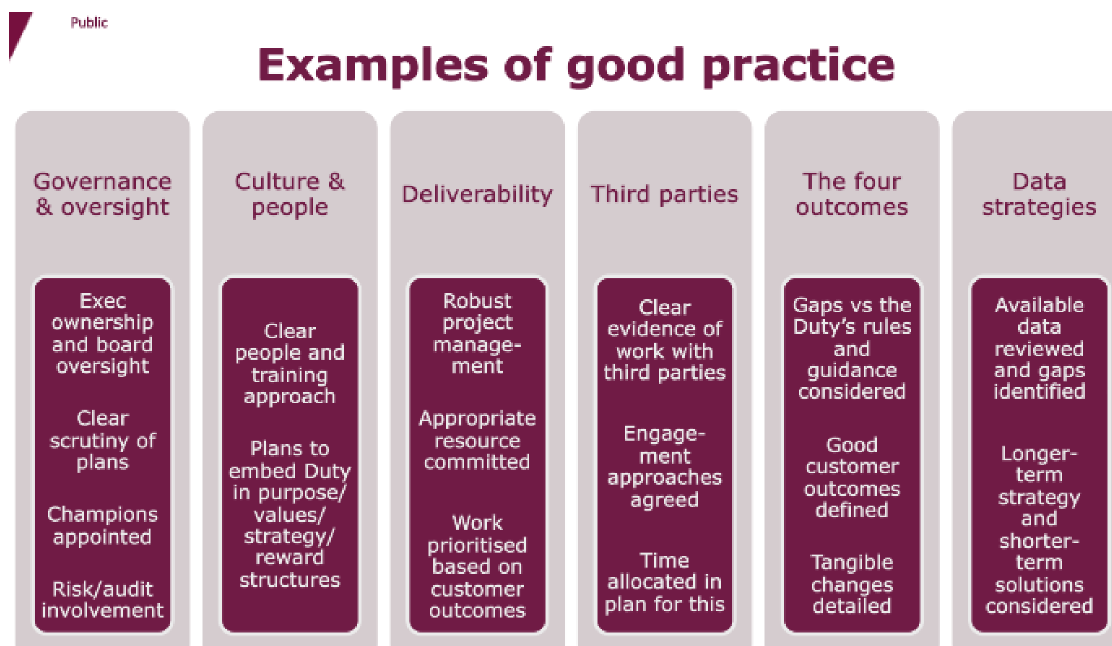
4. *Consumer support*

- Suggested considerations and actions for wholesale firms.
- Do we have retail customers?
- The first step is for wholesale firms to review whether they actually have a direct relationship with any retail customers. As part of MiFID II implementation — firms are likely to have had to classify all their clients into retail, professional and eligible counterparty. A check should be done on systems to see whether there are retail clients in the parts of business units or entities that deliver wholesale activities. If firms are not confident that their systems are accurate, they will need to consider other ways of finding out this information. Firms will also need to review their classification process and re-validate that customers who were opted out of retail classification were classified this way for appropriate reasons — i.e. that the professional category does not contain hidden retail customers that shouldn't have been opted up in the first place.
- If retail customers are found, the requirements contained within Consumer Duty will apply. While considering their clients' best interests, firms may wish to evaluate whether the business gained from what may be a very small population of retail customers is worth the effort and resources (both initially and ongoing) that will be needed to align with Consumer Duty.
- Do we manufacture products that are sold to retail clients?
- In its finalised guidance (PDF 1.13 MB) the FCA has said that 'the Duty applies to firms that have a material influence over, or determine, retail customer outcomes. For example, it applies to firms that can influence material aspects of or determine the design or operation of retail products or services, including their price and value'.
- Therefore, even if the firm does not deal directly with retail customers they may be caught by the 'look through' obligation. With this guidance, wholesale firms that manufacture regulated products and services that are then distributed by other firms to retail clients will need to be compliant with consumer duty. For each of the outcomes above, there is the expectation that:
- Firms should assess their client base and the full range of services provided.
- If there is any ambiguity on whether a firm is materially influencing retail customer outcomes, it should document its view and its rationale.
- Firms review their current approaches to bring them in line with the Consumer Duty expectations.
- Firms determine a target market and establish what a good outcome is for all key points with each product lifecycle and customer journey
- Firms embed consideration of characteristics of vulnerability within all aspects of the Consumer Duty
- Ultimately, firms can ensure they can evidence good outcomes in product/service design and operation, pricing and value, customer understanding and customer support.
- Outcomes are reviewed and monitored on an ongoing basis.
- Any issues identified are remedied or mitigated and root cause analysis addresses reoccurring issues.
- The FCA has confirmed (PDF 202 KB) that high net worth and sophisticated clients are still retail clients and could be captured by the Duty.
- How are we complying with the scope of the requirements?
- Reassuringly, the FCA recognises the concept of proportionality in the application of Consumer Duty. This is proportionality in the sense of the level of involvement and

influence in the distribution chain, the greater involvement or influence — the more firms need to do. The FCA also considers the level of risk the product/service exposes the retail clients to. So firms manufacturing higher risk products will require more efforts to satisfy the requirements. The FCA made it clear in its Policy Statement (PDF 1.3 MB) on the Duty that if firms comply with existing PROD rules, which are the FCA's handbook rules that implement MiFID II product governance rules, then those firms would comply with the FCA's expectations on the products and services outcome under the Consumer Duty. However, the scope of Consumer Duty is broader than the scope of products referred to in PROD, therefore if firms manufacture services as well as products they will need to consider the specific circumstances and their compliance.

- On the price and value outcome, this may not be totally in the manufacturer's control, but they are likely to have some input. Firms will need to review the FCA's expectations for this outcome, possibly in conjunction with the distributor or co-manufacturers.
- The FCA has emphasised that the Consumer Duty is an outcomes-based regulation — so key to firms' compliance will be their ability to measure and evidence consumer outcomes. For manufacturers, importantly this will partly derive from requesting information from distributors. Industry agreed solutions, such as common templates, are developing in the market to meet the expectations of Consumer Duty. However, firms need to consider whether there is sufficient information in these solutions to meet their own risk appetite and culture.
- Wholesale firms are likely to have less influence over the consumer understanding or consumer support outcomes. However, they will still need to be considered. For example, if the manufacturer's term sheet or terms and conditions for the product is being sent on directly to the retail consumer, it should review whether it is written in language that a retail consumer could be expected to understand, and whether the firm's contact details are provided.
- Are our data or services used to deliver retail products or services?
- The FCA has signalled that it is considering Consumer Duty in all its supervisory interactions. For example, in its supervisory portfolio letter (PDF 215 KB) to Benchmark Administrators, the FCA highlighted that although benchmark administration activities are not within scope of Consumer Duty, it is likely to apply to other firms in the distribution chain of products in which benchmarks are used. Therefore, the FCA expects benchmark administrators to support users of their benchmarks in meeting their obligations under the Duty. It is not completely clear what this means in practice, but it is clear there will be indirect implications where these firms' clients have their own obligations.
- Using this example, firms that use benchmarks in products that are delivered to retail clients will need to evidence that their products are delivering fair outcomes to retail clients and therefore they need to be comfortable that the benchmark is reliable and fairly representing data. The firm using the benchmark may then ask the benchmark administrator to evidence or to confirm this. Benchmark administrators may find they get asked similar questions from a number of clients.
- The FCA has indicated (PDF 202 KB) that custody and fund services firms may be captured by aspects of the requirements (for example, transfer agency services or depositaries' communications), but also noted that delivering outsourced services to asset managers could result in needing to consider the Consumer Duty.

- Firms that know their services, data or products are being used by firms that need to comply with Consumer Duty need to consider how they can respond to similar queries or requests from their clients.
- KPMG's UK firm professionals can assist with Consumer Duty and are currently advising clients on the navigation of these requirements, what it may mean for their business and providing implementation support.
- For further articles on Consumer Duty, including how to assess price and value, implementation challenges and how the FCA will supervise, please visit our Consumer Duty hub.



Moving forward with the Consumer Duty; *Sheldon Mills; Executive Director, Consumers and Competition; I've been out and about meeting firms this month to understand how they are getting ready to implement the Consumer Duty.*

- It's been positive to hear how some firms are already using the Duty to innovate by using their implementation work to find new ways of doing things, and making meaningful, customer centric, changes.
- This is exactly the type of cultural and operational shift we are hoping the Duty will bring about.
- We know making changes of this scale require significant effort and resource which is why we listened to your feedback and introduced an extended and phased implementation deadline. It's great to see the evidence of the effort you are making to meet the deadline, and we want to thank you for your hard work.
- And as I set out in my speech yesterday, we're committed to help you deliver these changes. As part of our continued support, we are publishing a series of letters setting out our expectations for firms in different sectors. These set out our expectations for how firms should embed the Duty in each sector, including relevant examples of good and poor practice, our approach for supervising the Duty, and planned next steps. We've also published Inside FCA podcasts exploring each of the Duty's four outcomes.

- We'll continue to provide additional resources in the months to come, and I look forward to hearing more about how firms are embracing the spirit of the Duty.

FCA publish speech by Sheldon Mills: Call of Duty : How putting customers front and centre will help industry innovate; *On 22 February 2023, the FCA published a speech by Sheldon Mills, its executive director for consumers and competition, given at the 'Countdown to Implementation of the Consumer Duty' event, on how putting customers front and centre will help the industry innovate.*

- In his speech, Mr Mills reiterates the importance of the Consumer Duty (**Duty**) and why the FCA embarked on it in the first place. He explains that the Duty was designed to set and test higher standards and to reduce and prevent serious harm. As an outcomes-based approach, data and monitoring is key and it is hoped this will give firms the impetus to target their customers more accurately through new technologies and systems. The Duty is also intended to reduce customer complaints, cut down costs down the line and boost competition.
- The speech also reminds firms of some of the key deadlines, as well as practical steps that they need to take. The Duty implementation deadline for open products and services is 31 July 2023, and 31 July 2024 for closed products. To prepare, over the next five months, firms should share information with their commercial partners and make sure they are on board; this will include the firm's distribution network and wholesalers as well as retailers and any third parties. Mr Mills also advises firms to focus on the areas that will have the biggest impact on outcomes for customers.
- The speech notes that the FCA is in the process of sending out industry-specific letters, which build on the guidance firms already have and help firms understand the FCA's priorities for embedding the Duty in their business area. Furthermore, the FCA has made a wide range of resources available on their website including their finalised guidance.
- Mr Mills flags that the Duty is not retrospective, so it will not mean organisations will be taken to the Financial Ombudsman Service for past actions or omissions so long as they are put right by July 2023 for products or services that are still on offer (or by July 2024 for those that have been withdrawn to new customers). At every stage of the regulatory life cycle, the FCA will ask firms to demonstrate their business models, actions they have taken and how their culture is refocusing on good customer outcomes.
- Finally, the speech highlights the need, by the end of April, for manufacturers to complete all reviews necessary to meet the four outcome rules (which relate to the governance of products, price and value, consumer understanding, and consumer support) and to share information with distributors to help them meet their obligations.

There is a lot to keep track of with the Consumer Duty and we expect you will have seen the FCA's findings from its review of larger firms' implementation plans. *There are some useful nuggets in relation to governance, oversight and culture (amongst other things) where the FCA have identified examples of "good practices" and "areas for improvement". For us, the key takeaways are the importance of scrutiny and challenge by the Board and responsible executives and ensuring there are effective minutes documenting this. Further, the importance of timely engagement of stakeholders in the 2nd and 3rd line, of clear tangible methods of implementing cultural change, and ensuring governance forums are updated in order for there to be an effective review process to ensure delivery by 31 July 2023. In more detail:*

- Many firms had developed robust governance frameworks with clear executive accountability and good engagement with both executives and NEDs (they call out 1-1 deep dive sessions with the Board as good practice). However others lacked detail on

who was leading the implementation programme and specific workstreams and in some cases there had been limited Board/Committee involvement and/or scrutiny and challenge – e.g. plans were approved without appropriate discussion (as detailed in the minutes). Aside from ensuring the right challenge and scrutiny occurs, this also highlights the critical importance of minuting Board and Committee meetings effectively during implementation and how the FCA may use them in its supervisory and enforcement capacity.

- Many firms had appointed an appropriately senior Consumer Duty Champion. One firm appointed two to reflect the diversity of their regulated entities which the FCA called out as good practice. Others, however, were slow to appoint Champions, or proposed individuals who were not sufficiently senior to provide effective challenge. Some firms suggested sharing the Champion across the entire board or executive, which the FCA made clear is not their intention and would dilute the role.
- Most firms had clear arrangements for ongoing updates to key governance forums including the Board, but others had no timing for progress updates or details on future engagement with governance forums. Further, others lacked detail on Board engagement post-implementation. Both were given as examples of areas for improvement.
- Broadly, firms were seen to be involving the risk, compliance and internal audit teams in a timely way, although some plans didn't include a summary opinion from such teams. This may be something to consider if your firm has not done so already.
- Many firms appeared to have a clear approach to training to ensure staff understand their responsibilities under the Duty, and there was good evidence of firms embarking on communication campaigns and raising awareness – e.g. townhalls. Others were embedding the Duty within their purpose, values and internal culture materials as well as in their strategy, governance structures and decision-making. However, other plans lacked such detail and provided inadequate explanations of the tangible actions firms would take. From what we have seen, firms are looking at how to make training tailored and appropriate for different categories of staff (e.g. back office staff for whom only part of their role relates to retail business) and how they assess breaches of the new Conduct Rule 6 in practice. We are developing tailored training for firms across functions and types of entity so please get in touch if this is of interest.
- Many firms were conducting reviews of their reward and incentive structures and performance management frameworks to ensure they reflect the Duty, with some firms updating their SMCR framework to ensure senior leaders were leading the cultural change needed.

On 21 February 2023, the FCA updated their press release: FCA supports firms through the transition to implementing the Consumer Duty. The webpage has been updated to include links to the following portfolio letters:

- Debt advice
- Debt purchasers, debt collecting and debt administration (DPCA) services
- Payment services and e-money

On 20 February 2023, the FCA published Discussion Paper 23/2 'Updating and improving the UK regime for asset management' (DP23/2).

- Under the Future Regulatory Framework, the government has proposed making the FCA responsible for those retained EU laws that set requirements for firms. This means the FCA will need to decide whether its rules should in future copy those requirements.
- As a first step, the FCA has published DP23/2 to gather a broad range of views about the current UK regime for regulating funds and asset managers. It sets out a range of ideas about how the FCA might modernise and tailor the regime to improve outcomes for UK markets and consumers, and to support the UK's position as a world-leading centre for asset management. Any changes are intended to be consistent with international standards and to enable technological development and innovation.
- Potential changes suggested in the paper include clarifying and enhancing the rules applicable to authorised fund managers and depositaries, improving the rules that apply to funds, and using technology and innovation to support better outcomes from authorised funds.
- Alongside DP23/2, the FCA plans to engage with a wide range of stakeholders in forums and roundtables as well as individual meetings. Depending on feedback, it will look at ways to develop some of the ideas covered in the paper using tools such as policy sprints.
- The deadline for feedback to DP23/2 is 22 May 2023. A Feedback Statement is planned for later this year, possibly as part of a consultation paper.

FINRA alert highlights fraudulent email scam The Financial Industry Regulatory Authority has issued an alert to financial professionals about an email scam using messages that claim to be from the regulatory body. FINRA identifies some of the domain names that scammers may use and warns not to "call phone numbers listed in suspicious emails or text messages, as threat actors use these as a method of establishing contact with a targeted victim to extract personal information or solicit a fraudulent payment (this tactic is known as callback phishing)." Full Story: ThinkAdvisor (free registration)

The PRA has published a letter setting out the priorities in 2023 for international banks active in the UK, and outlines that, alongside the CEO (SMF 1), individuals within the SMCR will be accountable for addressing the priorities set out in the letter.

- These priorities include operational risk and resilience, data, financial risks arising from climate change (for which we remind dual regulated firms that the PRA have created a quasi-prescribed responsibility whereby a Senior Manager must hold responsibility for this) and diversity, equity and inclusion ("DEI"). Senior Managers for international banks active in the UK should review these priorities and ensure they are appropriately discussed and addressed, as applicable.
- With respect to DEI, the PRA confirms that they still plan to issue a consultation paper in 2023 setting out their proposals to introduce a new regulatory framework on DEI in the financial sector

PRA - PS 1/23 – Remuneration: unvested pay, MRTs and public appointments; *We talked a lot about remuneration in last month's SMCR+ View. More recently, the PRA published its Policy Statement in response to feedback on CP8/22 and the PRA's proposal to add a new section to Chapter 4 of SS2/17, setting out the PRA's expectations that:*

- (1) in general, unvested, deferred claims that comprise the variable pay of MRTs should not be converted from an equity claim into a claim on other instruments (or vice versa) after an award has been made;
- (2) this expectation should apply to all unvested, deferred sums, and not exclude amounts above the regulatory minima; and

- (3) in exceptional circumstances, such as where there are potential conflicts of interest arising from a (proposed) public sector appointment that cannot otherwise be sufficiently mitigated, it may be appropriate for a conversion to occur subject to the PRA's prior non-objection, and on the basis that the relevant retention requirements remain unchanged.
- It was also proposed that SS2/17 be amended to outline the circumstances in which the PRA considers it more likely a waiver or modification to the relevant remuneration rules would meet the FSMA statutory test, where, in wholly exceptional circumstances, an adjustment is sought in relation to a public sector appointment with a view to converting an award comprising equity or other instruments to a cash sum.
- Broadly, the PRA is proceeding with the proposals and the Policy Statement follows the consultation paper but with some minor tweaks and adjustments to provide further clarity. The new policy took effect from 10 February 2023.

PRA - CP2/23 on moving the SMCR forms from the PRA rulebook and Form A changes; *CP2/23 sets out its proposals to remove certain SMCR forms from the PRA Rulebook (they would be available in Connect instead).*

- This would result in amendments to the Senior Managers Regime – Application and Notifications Part of the PRA Rulebook resulting in the removal of links to forms A, B, E, I, J and the statement of responsibilities. Why? Well it would mean administrative and non-material changes to the forms wouldn't have to go through the formal statutory consultation process and notice of any changes would be published on the Senior Managers Regime pages on the PRA website instead.
- Perhaps of most interest, however, is that the PRA have said one of the reasons for doing this would be to support any future changes to forms that may result from the SMCR review announced by HM Treasury as part of the Edinburgh Reforms. So it seems likely we can expect changes to these in the future.
- Note, Forms C and D would remain in the Rulebook as they are made by rules.
- The PRA also proposes to change the length of employment history required in the long form A from 5 years to 10 years, in order to align with the requirements under MiFID related forms (there seems to be an irony here given the Edinburgh Reforms narrative…).
- The consultation closes on Tuesday 28th February 2023.

Ion cyber outage continues as banks rely on workarounds; ABN Amro, Macquarie, RBC among firms hit; ransom deadline tomorrow, but service may be down for days; 03Feb2023.pdf
Updated OTC Derivatives Compliance Calendar – Updated for February 2023

Global regulators issued record fines in 2022 Financial regulators in the UK, US, Germany, France, and the Netherlands cracked down on compliance violations in 2022, resulting in some record fines and penalties, according to data from SteelEye's Fine Tracker. SteelEye CEO Matt Smith notes that "regulators are using powerful data analytics tools to identify malpractice more accurately among the companies they regulate, meaning more firms are at risk of scrutiny." The Trade Finance Magnates

The Financial Industry Regulatory Authority (FINRA)'s head of enforcement, Jessica Hopper, who has served with the US brokerage regulator for the past 18 years, is to step down on 3

February. *She will be replaced in the interim by deputy head of enforcement Christopher Kelly as acting head, during the process of selecting a permanent replacement.*

- FINRA is a private body, overseen by the SEC, which regulates brokerage firms and exchange markets. Self-regulatory for its members, it writes and enforces rules for the sector as well as examining for compliance with federal securities laws. The agency also provides surveillance and regulatory services for the equities and options markets and administers TRACE (the FINRA-developed Trade Reporting and Compliance Engine), which facilitates the mandatory reporting of over-the-counter transactions in eligible fixed income securities.
- Hopper has been executive vice president and head of enforcement since January 2020, after being named acting head of enforcement in September 2019. She joined FINRA in 2004 as an enforcement attorney, before being promoted to vice president in charge of the regional enforcement program in Washington DC and, in 2016, becoming deputy head of enforcement.
- During her tenure the department brought enforcement actions for a broad range of violations of both FINRA rules and federal securities laws and regulations: including excessive trading, supervision; anti-money laundering, Reg SHO, best execution of customer orders, customer protection rule, operational failures, reporting requirements, test cheating and failures to provide information in connection with an investigation. She also spearheaded the integration of two separate enforcement teams within the organization (one handling disciplinary actions related to trading-based matters found through Market Regulation's surveillance and examination programs, and the other handling cases referred from other regulatory oversight divisions including Member Supervision) which contributed to both greater efficiency and enhanced transparency.
- The agency also issued record sanctions on member firms for systemic supervisory failures under her aegis: including a $57 million fine to Robinhood Financial in 2021 for its role in the meme stock saga, which saw the firm hit with $12.6 million in restitutions to its customers.
- In 2022, the enforcement department also fined Credit Suisse $9 million for numerous operational failures, as well as slapping Deutsche Bank Securities with a $2 million penalty for best execution violations. "Jessica has contributed immensely to FINRA's mission to protect investors and ensure market integrity," said FINRA president and CEO Robert W Cook. "With Jessica at the helm, the Department of Enforcement returned millions of dollars to wronged investors, vigorously pursued complex cases throughout significant market disruptions, and completed a reorganisation that has fostered an even more efficient and effective enforcement program. I thank Jessica for her steadfast commitment to our mission and her long, exceptional service to FINRA."

FINRA AWC: Herbert J. Sims & Co, Inc. settled FINRA charges for failing to implement an AML program "designed to detect and cause the reporting of suspicious cyber-events." *According to FINRA, the broker-dealer's cybersecurity policy had no requirement to review cyber-events for AML purposes and file suspicious activity reports accordingly.*

- As a result, FINRA said that the broker-dealer failed to investigate five cyberattacks, one of which resulted in a bad actor wiring funds to a third-party account. FINRA said that the broker-dealer failed to file any suspicious activity reports on the cyberattacks.
- FINRA determined that the broker-dealer violated FINRA Rule 2010 ("Standards of Commercial Honor and Principles of Trade") and Rule 3310 ("Anti-Money Laundering

Compliance Program"). To settle the alleged rule violations, the broker-dealer agreed to (i) a censure and (ii) a civil monetary penalty of $100,000.

FCA commences criminal proceedings against five individuals for conspiracy to commit insider dealing and money laundering; *Demonstrating its continuing focus on preventing, detecting and punishing market abuse, on 25th January 2023, the FCA announced that it has commenced criminal proceedings against five individuals, alleging that they conspired to commit offences of insider dealing between December 2019 and March 2021. In addition to insider dealing, the five individuals are charged with money laundering offences.*

- One of the individuals was previously an analyst at asset manager Janus Henderson and the FCA alleges that he used confidential information that he accessed in this role to facilitate trading in 49 companies through accounts held by his co-conspirators, resulting in a profit of approximately £1.5 million. The FCA believes that the defendants used Contracts for Difference (CFD) in relation to each of the companies, betting that the value of shares would go down after announcements.
- The case follows a number of enforcement actions by the FCA in relation to market abuse over recent months and acts as a reminder that the FCA can raid sites where it suspects that there may be relevant evidence, with the FCA noting in its announcement that in March 2021 a multi-site search and arrest operation was conducted by it with the assistance of the Metropolitan Police. Also of note some of the alleged offending took place during the pandemic when many individuals were working remotely. The FCA identified at the time that home working arrangements, together with the migration of certain employees to alternative sites, had the potential to raise new risks in relation to the handling, and potential unlawful disclosure of inside information.
- Firms need to ensure that they have robust systems and controls in this area and stay on top of FCA guidance and feedback, including Market Watch publications. In a December 2022 Dear Portfolio letter, the FCA stated that it remained concerned about the level of suspicious activity in the CFD sector and that it will consider enforcement action where it identifies firms operating materially below its minimum standards. The defendants will appear at Southwark Crown Court next month for a Plea and Case Management Hearing.

FCA publishes feedback to CP21/30 and consults on new rules and perimeter guidance; O*n 2 February 2023, the FCA published Consultation Paper CP23/5 Debt packagers: Feedback on CP21/30 and further consultation on new rules and perimeter guidance.*

- In November 2021, the FCA published CP21/30 which proposed to ban debt packagers from receiving referral fees, after the FCA found evidence that that there was an acute conflict of interest inherent in the debt packager business model and which firms did not appear able to manage. However, having reflected on the feedback it received to CP21/30, the FCA decided it would be appropriate to gather more evidence showing how debt packager firms manage this conflict of interest, in particular from parts of the market not as strongly represented in the FCA's existing evidence base. The FCA has since analysed this further evidence, finding that it supports their original conclusions that debt packagers do not appear to manage the identified conflict of interest well.
- The proposals; In CP23/5, the FCA is proposing to make the rules as set out in CP21/30, with minor amendments. The FCA is reconsulting to allow stakeholders to comment on the analysis of the expanded evidence base, to give feedback on the proposed implementation period and, given the passage of time since the original consultation, to allow the opportunity to raise any new issues or developments in the market of which the FCA should be aware.

- The FCA is also seeking views on proposed perimeter guidance to clarify the boundary of the regulated activity of debt counselling in relation to activities commonly carried out by unauthorised lead generators.
- Next steps; The deadline for feedback to the consultation is 2 March 2023.

FCA publishes review of Consumer Duty implementation plans; *The FCA has published a review of how firms are planning to implement the Consumer Duty.*

- The rules and guidance will come into force on 31 July 2023 for new and existing products or services that are open to sale or renewal, and 31 July 2024 for closed products or services.
- The FCA has reviewed a sample of implementation plans and found that many firms have established extensive programmes of work to comply with the Consumer Duty properly. However, the FCA also found that some firms are further behind in their planning, so there is a risk that they may struggle to apply the Consumer Duty effectively once the rules come into force.
- Over the remaining six months of the implementation period, the FCA wants firms to focus particularly on:
    - prioritising effectively, with a focus on the areas that will make the biggest impact on outcomes for consumers;
    - making the changes needed so consumers receive communications they can understand, products and services that meet their needs and offer fair value, and get the customer support they need, when they need it; and
    - sharing information and working closely with commercial partners to make sure they are all delivering good customer outcomes. The FCA has found that some firms need to accelerate this work to implement the Duty on time.
- The FCA urges firms to consider the findings from the review and to develop their implementation plans and approach in line with good practice where appropriate. The FCA intends to issue letters to firms to highlight its key expectations on implementing the Duty and some of the key risks and consumer harms the FCA is concerned about in their sectors

AML/CFT: FCA publishes feedback on cryptoasset businesses' applications under MLRs; *The FCA has published feedback on good and poor quality applications made by cryptoasset businesses under the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 as amended (MLRs).*

- In its role as the anti-money laundering and counter terrorist financing (AML/CFT) supervisor of cryptoasset businesses, the FCA has received over 300 applications for registration under the MLRs since 10 January 2020. The feedback is intended to help applicants as they prepare their application for registration and make the process as simple and efficient as possible. The feedback sets out the FCA's expectations of applicants during the various stages of applications including the preparation, submission and review stages

BaFin publishes report on risk focus for 2023; *The German Federal Financial Supervisory Authority (BaFin) has published a report on the risks in its focus for 2023.*

- In BaFin's view, one of the major risks facing the financial sector is the rapid rise of interest rates, which has already affected the profitability of many banks due to losses in their securities portfolios. It notes that another sudden and sharp rise of interest rates would put a heavy burden on some institutions.

- In its report, BaFin identifies the following six main risks which, in its view, could most endanger the financial stability and integrity of the German financial system, and explains what it is doing to contain these as best as possible:
    - risks from abrupt interest rate rises of significant magnitude;
    - risks from corrections on the real estate markets;
    - risks from significant corrections in the international financial markets;
    - risks from the default of loans to German companies;
    - risks from cyberattacks with serious consequences; and
    - risks from insufficient prevention of money laundering.
- In addition, BaFin has identified three key future trends which pose risks that BaFin and the companies it supervises will have to focus on intensively: sustainability, digitalisation in the financial sector, and geopolitical changes. The report notes that these will shape business models in the financial sector in the long term.

SEC WhatsApp Probe Expands to Phones of Hedge Fund Employees; Point72 and Citadel among industry recipients of request; Officials seeking evidence of business on unofficial platforms; Major hedge funds have been asked by US regulators to review certain employees' personal mobile phones as part of a mushrooming probe into Wall Street's use of unofficial messaging platforms like WhatsApp to conduct business. The SEC recently asked Steve Cohen's Point72 Asset Management, Ken Griffin's Citadel and several other firms to search through the devices for evidence of business dealings on unapproved channels, according to people familiar with the matter who asked not to be identified discussing the private requests. /jlne.ws/3kVUnGc

Jo Johnson, the investment bank and the Adani allegations; Well, well... Lord Jo Johnson has abruptly resigned as a director of an investment bank with links to Indian business magnate Gautam Adani, after less than a year on its board. Lord Johnson, the younger brother of former prime minister Boris Johnson (and a former FT journo), resigned from Elara Capital on February 1st, according to Companies House records. That was after FT Alphaville contacted him for comment and visited Elara's offices on Tuesday, and was politely but swiftly shown the door. /jlne.ws/3DDwD08

Microsoft rolled out a premium Teams messaging offering powered by ChatGPT to simplify meetings using the AI chatbot that has taken Silicon Valley by storm. ChatGPT is estimated to have reached 100 million monthly active users in January, just two months after launch, making it the fastest-growing consumer application in history.

How to organise a COO' – speech by FCA's Emily Sheppard; *On 8 February 2023, the FCA published a speech by its Chief Operating Officer (**COO**) and Executive Director of Authorisations, Emily Sheppard on "How to organise a COO". In her speech, Ms Sheppard shares some of her experience as an industry COO.*

- An open culture
- Firstly, Ms Sheppard highlights the need for COOs to use the levers of 'soft' power such as open communication as much as 'hard' power such as data and rules to mitigate non-financial risk. She notes the importance of informal conversations, of asking questions and of getting people to talk early on before they become too institutionalised.
- Diversity and inclusion

- Ms Sheppard flags that whilst many firms are great at making sure that they have a diverse workforce, they are not so good at inclusion. Diversity and inclusion are about far more than targets – true inclusion means that people feel free to speak out.
- More action on ESG
- One area of non-financial risk that Ms Sheppard raises as needing more work is in environmental, social and governance (ESG). The role of the COO is to demonstrate integrity in their firm's products, people and promises. The FCA wants to clamp down on greenwashing and consider how to incentivise best practice and will, in the coming days, publish a paper on the role regulations can play in driving positive change.
- Focus on clients.
- Ms Sheppard reminds firms that now is a good time to line up their distributors and other third parties to make sure they understand the principles and practice of the Consumer Duty. The FCA asks that firms put clients at the centre of the products and services offered and that they can demonstrate the decision-making process around that. The FCA also asks that the information firms provide is clear and relevant to their target market.
- Agility, assertiveness, innovation
- To conclude her speech, Ms Sheppard notes that the FCA is an innovator as much as a regulator, embracing change and helping new industries flourish while protecting consumers from harm. She reminds COOs that they will have to deploy at speed traits that are needed at times of more radical changes, ensuring they are agile, assertive, and innovative in how they deal with people and risks and that they have tested their operational resilience plans.

SEC expanding the scope of its investigation into the use of unauthorized communications channels – turning its attention to hedge funds. This is the first sign that the focus is now shifting away from Wall Street giants and to the next tier, as predicted.

- In the most recent Wall Street WhatsApp development, the SEC has asked a number of hedge funds to hand over personal mobile devices belonging to certain employees. Another tier one firm has also confirmed that it has been pulled into the SEC's investigation, although it is unclear if they have been asked to hand over personal mobile devices belonging to their employees.
- The regulator has described this as the next step in its WhatsApp investigation, as it expands the scope of its messaging compliance probe.
- The concern is that hedge fund employees have been using personal phones and unapproved channels such as WhatsApp to conduct business. The regulator worries that these channels are being used to conduct illicit conversations, to ultimately evade market oversight.
- "Unfortunately, in the past, we've seen violations in the financial markets that were committed using unofficial communications channels, such as the foreign exchange scandal of 2013. Books-and-records obligations help the SEC conduct its important examinations and enforcement work. They build trust in our system," said SEC Chair Gary Gensler in relation to one of the Wall Street fines.
- In 2022, the SEC handed out a record number of fines to financial firms that totaled $6.4 billion, smashing the previous high set in 2021. A sizeable portion of those fines was tied to large tier-one banks, specifically related to their use of unmonitored messaging platforms like WhatsApp. However, in November 2022, SteelEye predicted that regulatory scrutiny would soon turn to the smaller firms, as we have now seen.

- The announcement to hand over personal devices has drawn considerable ire and resistance from top industry trade groups, including the US Chamber of Commerce, American Investment Council, Investment Company Institute, and the Managed Funds Association.
- The groups have collectively written to the SEC chair about what they believe are "serious privacy implications." While these committees are positioning the entire probe as unreasonable and excessive, the SEC has made it clear that they will not let up in their investigation and that they are within their rights to demand these additional measures, including the handing over of phones.
- In response to a tightening regulatory clasp, several firms have announced changes to mitigate the future risk of unmonitored communications. For example, one firm has announced that it will be issuing self-imposed fines of up to $1m for employees that violate the company's policies regarding the use of unmonitored channels. However, this approach has been questioned by many industry practitioners who believe it is a reactive and short-term solution to a much bigger problem that needs to be addressed with a technology-led approach.
- Managing eComms is a systemic challenge across the industry and in 2022, only 4% of smaller financial firms viewed increasing the coverage of different communications channels as a compliance priority, and only 15% of firms overall were monitoring WhatsApp. These figures were revealed in SteelEye's 2022 Compliance Health Check Report.
- If the initial crackdown that took place in 2022 was not enough for firms to reconsider their stance on monitoring eComms, the increased scope of the SEC's probe will likely get the message across.

On January 1, 2023, speculative position limits became applicable to certain over-the-counter swaps (in addition to exchange-traded futures) for the first time in the United States. *Specifically, these new limits apply to swaps that are "economically equivalent" to any futures contracts or options on futures contracts subject to federal position limits. However, market participants face uncertainty as to which swaps are considered "economically equivalent" (and thus subject to position limits), and some are concerned that the scope may be broader than many initially believed.*

- "Speculative" position limits are caps imposed on each trader's positions in a given futures contract during the end of trading for a given delivery month (i.e., the "spot month"). These limits are generally intended to prevent excessive speculation and the potential for manipulation, as well as unnatural price fluctuations. In November 2020, the CFTC (CFTC) voted to finalize regulations to expand the types of products subject to such limits from certain agricultural futures contracts (as had previously been the case) to also include certain energy and metals futures contracts.[1]
- In the same rulemaking, and after proposing to do so several times, the CFTC also expanded position limits to cover swaps that are "economically equivalent" to the futures and options on futures that are themselves subject to the CFTC's position limits. However, the CFTC decided to delay the compliance date for economically equivalent swaps until January 1, 2023, because "exchanges cannot view market participants' positions in swap positions across the various places they trade, including on competitor exchanges."[2]
- What are "economically equivalent" swaps?

- CFTC regulations define an "economically equivalent swap" as "with respect to a particular referenced contract [i.e., a futures or option on futures contract that is subject to federal position limits], any swap that has identical material contractual specifications, terms, and conditions to such referenced contract."[3] The CFTC explained that "material" specifications, terms, and conditions are limited to those provisions that drive the economic value of a swap, including with respect to pricing and risk, and that examples of "material" provisions include the underlying commodity, including commodity reference price and grade differentials; maturity or termination dates; settlement type (i.e., cash-settled versus physically-settled); and, as applicable for physically delivered swaps, delivery specifications, including commodity quality standards and delivery locations.[4] The CFTC further stated several times in the adopting release that its definition of "economically equivalent swaps" was intentionally narrow.[5]
- Therefore, market participants could interpret the rule to mean that a swap is only "economically equivalent" to a given referenced contract if it has terms that are **identical** to the **material terms** included in **that specific** referenced contract. Furthermore, given that the CFTC identified settlement type as one of the material terms of a referenced contract, many market participants have taken the position that swaps are only subject to position limits if they are settled in the same manner as the futures contract referenced (e.g., as the Commodity Reference Price) in the swap confirmation.
- This would indeed be a small subset of swaps that are subject to position limits. For example, in the context of natural gas swaps, a swap referencing NYMEX's NG contract would **not** be subject to position limits because the swap would (presumably) be cash-settled and the NG contract is physically settled. However, a swap referencing ICE Futures U.S.'s H contract **could** be subject to position limits (assuming all other material terms were identical) because both contracts are cash-settled.
- The CFTC has given little public guidance on this issue or the application of position limits to swaps generally, resulting in a growing belief that the scope of swaps subject to position limits is indeed very narrow. However, the CFTC's Division of Market Oversight (DMO) recently created uncertainty by indicating in a non-public communication[6] that a swap may be economically equivalent if it mirrors **any** referenced contract (not merely the contract actually referenced in the swap), including cash-settled look-alike contracts. As a result, market participants with swaps that reference physically settled futures contracts may be required to count those swaps toward their position limits if there is any cash-settled referenced contract that settles against the price of the physically settled future.[7]
- **The due diligence safe harbour**
- In the adopting release, the CFTC did recognize that determining which swaps are "economically equivalent" may be difficult and provided a mechanism to mitigate concerns that market participants may face enforcement risk due to that uncertainty. Specifically, the CFTC stated that it will not pursue any enforcement action against a market participant for violating federal position limits for swaps as long as, with respect to such swaps, the market participant "(i) performed the necessary due diligence and is able to provide sufficient evidence, if requested, to support its reasonable, good-faith determination that the swap is or is not an economically equivalent swap and (ii) comes into compliance with the applicable federal position limits within a commercially reasonable time, as determined by the Commission in consultation with the market participant, and if applicable, any relevant exchange."[8]

- Thus, market participants with swaps that reference futures subject to federal position limits may mitigate risks that they would be found to violate position limits if they conduct an analysis of their swaps and come to a reasonable, good-faith determination that, based on the specific facts at hand, the swaps are not economically equivalent. This analysis should be documented and retained by such market participants in the event that the CFTC or a futures exchange request such information for review.
  1. *See* Position Limits for Derivatives, 86 Fed. Reg. 3236 (Jan. 14, 2021).
  2. *Id.* at 3247.
  3. 17 C.F.R. 150.1.
  4. Position Limits for Derivatives, 86 Fed. Reg. at 3291.
  5. *See, e.g., id.* at 3302 n.493 ("the Commission adopted an 'economically equivalent swap' definition that is narrower than the class of futures contracts and option on futures contracts that would be included as referenced contracts.").
  6. In a joint letter to the CFTC, dated December 16, 2022, the Futures Industry Association (FIA) and the International Swaps and Derivatives Association (ISDA) described this informal communication, which was sent by DMO to the FIA.
  7. Such swaps would be aggregated with (and netted against) the cash-settled futures, though, not the physically settled futures.
  8. Position Limits for Derivatives, 86 Fed. Reg. at 3295.

Compliance Under Fire: strengthening your approach to financial crime compliance; Bovill Webinar; Monday, 27 February 2023; 11am - 12pm; *Mark Spiers is joining our friends at Elephants Don't Forget for their panel discussion on financial crime compliance.*

- Alongside other panel members, Mark will be discussing the recent AML fines issued by the FCA and why it's crucial to design and deploy robust AML controls and systems in your firm, with a focus on:
- Strengthening your AML culture.
- Learning lessons from recent enforcement actions.
- Becoming more proactive in identifying financial crime risks.

2023 FCA publish Discussion Paper on finance for positive sustainable change: governance, incentives, and competence in regulated firms; On *10 February 2023, the FCA published Discussion Paper 23/1 'Finance for positive sustainable change: governance, incentives, and competence in regulated firms' (DP23/1). DP23/1 will be of interest to all regulated firms across the financial services sector. The aim of DP23/1 is to encourage an industry-wide dialogue on firms' sustainability-related governance, incentives, and competences. In the first part of DP23/1 the FCA:*

- Examines how governance, incentives and competence are considered in the Taskforce on Climate-related Financial Disclosures' recommendations, and how expectations in these areas are evolving with the work of the International Sustainability Standards Board, the UK's Transition Plan Taskforce and the Glasgow Financial Alliance for Net Zero.
- Considers more deeply firms' sustainability-related objectives and strategies, and how these are supported by their governance and incentive arrangements. In addition, the FCA reflects on how asset managers and asset owners organise and govern their stewardship activities to influence positive change.
- Considers firms' training and competence.
- In the second part of DP23/1 the FCA includes commissioned articles. These articles, together with the FCA's analysis, may help firms reflect on how their approaches to governance, incentives and competence support positive change. This may encourage

firms to review their practices, even without the FCA setting further regulatory expectations.

- The deadline for responses to DP23/1 is 10 May 2023.
- The FCA will use the feedback in considering what the industry would find most helpful in this evolving area. The feedback will also help the FCA consider in what direction it should take its future regulatory approach. The FCA will also consider firms' arrangements in many of these areas as part of its supervisory engagement with firms.

SEC Intensifies Crypto Enforcement with Exchange Settlement; Digital asset platform Kraken agrees to discontinue its U.S. staking program; The SEC escalated its enforcement campaign against the cryptocurrency industry Thursday with a settlement that could imperil a lucrative activity for other major crypto firms. On Thursday, Payward Inc.'s Kraken platform agreed to stop offering so-called crypto staking services in the U.S. and pay $30 million in penalties to the SEC. Staking allows investors to earn a yield by temporarily handing their crypto tokens over to either an intermediary or a cryptocurrency network /jlne.ws/3xiRmTb

ION attack highlights third-party provider risks Experts say that the cyberattack on ION Trading illustrates the vulnerabilities of firms that rely on third-party suppliers for critical technical infrastructure. Security firm Akamai Technologies chief security officer Boaz Gelbord says that cyber standards for these third-party providers "are being driven by the primary regulated entity," rather than regulators. The Wall Street Journal

'Substantial reduction' in bonuses at Deutsche Bank and Barclays as fallout from WhatsApp scandal continues; Deutsche Bank and Barclays have both cut bonuses for senior staff that inappropriately used WhatsApp as the fallout from an industry-wide crackdown on the use of private messaging services continues. According to Bloomberg, employees at Deutsche Bank who were found to be in severe breach of policies will see a "substantial reduction" in their bonus. /jlne.ws/3YXmIL1

ASIC prioritizes crypto in 2023 enforcement focus The Australian Securities and Investments Commission says that its 2023 enforcement priorities will focus on crypto investor protection, as well as sustainable finance practices and disclosure, financial fraud, and cyber and operational resilience. ASIC Deputy Chair Sarah Court says the financial market watchdog will also help firms meet their legal obligations "by providing simple, effective, and easy-to-access guidance." Finance Magnates

Deutsche Bank probe reportedly finds FX derivatives misconduct An independent probe conducted by a London-based law firm found that some Deutsche Bank staff had deliberately exploited flaws in the bank's internal controls during the sale of highly complex foreign exchange derivatives in Spain, sources say. The bank is currently facing a €500 million lawsuit from hotel group Palladium over alleged mis-selling activity. Financial Times

Market Structure

Prudential

ECB denies banks' request to rethink capital rules The European Central Bank has rejected banks' call to ease capital requirements and align them with those imposed by US regulators to boost lending across the bloc. The ECB said it disagrees with EU banks' contention that they are disadvantaged compared to their US peers. "The largest global European banks have even slightly lower requirements than their counterparts across the Atlantic," an ECB spokesperson said. Reuters

ESMA guidelines on stress test scenarios under the MMF Regulation; On 27 January 2023, the **ESMA** issued guidelines that apply in relation to Article 28 of the Money Market Funds Regulation and establish common reference parameters for the stress test scenarios to be included in the stress tests conducted by money market funds (**MMFs**) or managers of MMFs in accordance with that Article. The guidelines apply from two months after being published on ESMA's website in all EU official languages (the parts of the guidelines that are in red already apply from the dates specified in Articles 44 and 47 of the MMF Regulation). In accordance with Article 28(7) of the MMF Regulation, the guidelines will be updated at least every year taking into account the latest market developments.

Edinburgh Reforms: Ring fencing; consider the government's proposals so far for reforming the UK's ring fencing regime.

EBA launches 2023 stress test. On January 31st, the EBA released the macroeconomic scenarios for its 2023 EU-wide stress test. This year's adverse scenario features the most severe GDP decline to date and includes heightened geopolitical tensions, high inflation and higher interest rates having strong adverse effects on private consumption and investments, both domestically and globally. T his year's scenarioalso newly includes information on the growth of Gross Value Added (GVA) in 16 sectors of economic activity. The EBA expects to release results in July.

EU begins toughest bank stress test yet The European Banking Authority has launched the most stringent stress test yet, which covers 70 banks. The test not only includes an adverse scenario that exacerbates economic headwinds such as high inflation, high interest rates, high commodity prices and pandemic disruption but also examines credit risk for different sectors of the economy. Bloomberg Reuters The Wall Street Journal

BRRD: EU Commission adopts amendments to Delegated Regulation on ex ante contributions to resolution financing arrangements as regards methodology for calculating liabilities arising from derivatives; *The EU Commission has adopted a Delegated Regulation containing amendments to Commission Delegated Regulation (EU) 2015/63 on ex ante contributions to resolution financing arrangements under the Bank Recovery and Resolution Directive (BRRD) as regards the methodology for the calculation of liabilities arising from derivatives.*

- The Commission notes that the new method introduced by the second Capital Requirements Regulation (CRR2) for calculating liabilities arising from derivatives under the standardised approach to counterparty credit risk (SA-CCR) is not suited for the purposes of Delegated Regulation (EU) 2015/63, because its formulas are developed for

assets rather than for liabilities and the result of applying its formulas would create distortions in the calculation of liabilities arising from derivatives.

- The amending Delegated Regulation reinstates the current exposure method (CEM), renamed as the 'simplified exposure method', for calculating liabilities arising from derivatives, and inserts provisions equivalent to the original Articles 429, 429a and 429b of the CRR into Delegated Regulation (EU) 2015/63 as Articles 5a to 5e.
- The EU Parliament and EU Council have three months to scrutinise the Delegated Regulation. It will enter into force on the day following its publication in the Official Journal and will apply retroactively as of 1 October 2022.

Banking Package: ECON Committee adopts reports on proposed CRR3 and CRD6; *The EU Parliament's Economic and Monetary Affairs Committee (ECON) has adopted its reports on the EU Commission's legislative proposals for a regulation amending the Capital Requirements Regulation (CRR3) and a directive amending the Capital Requirements Directive (CRD6)*.

- Key elements of the proposals highlighted by the ECON Committee include, among other things:
  - on capital requirements, the need to consolidate the output floor at an EU level to allow for comparable risk weights and avoid variations in capital levels, and to allow competent authorities to address inappropriate distribution of capital among banking groups and propose a capital redistribution. The Committee also agreed on transitional arrangements for low-risk exposures secured by mortgages on residential property, which may be extended by up to four years;
  - on sustainable finance, the Committee agreed to strengthen reporting and disclosure requirements for ESG risk;
  - on cryptoassets, banks should disclose their exposure to cryptoassets and cryptoasset services, together with a description of their cryptoasset risk management policies;
  - on governance, the membership of banks' management bodies should be sufficiently diverse and gender balanced and, in the event that a key function holder ceases to comply with suitability criteria, that person must be replaced; and
  - new third country branches must not commence their activities in the EU until the European Banking Authority (EBA) and the relevant third country have concluded a memorandum of understanding (MoU) on a co-operation framework.
- The press release also notes that the Commission is invited to submit a legislative proposal on the merits of a dedicated prudential treatment for exposures to cryptoassets by June 2023.

Ion cyber outage continues as banks rely on workarounds ABN Amro, Macquarie, RBC among firms hit; ransom deadline tomorrow, but service may be down for days

- Experts warn ransom payment not the end of ION hack issues Cybersecurity experts are warning that ION Trading UK's systems will take time to recover and could remain vulnerable, despite reports that the ransom demanded by hackers following an incursion last week has been paid. "You might get the decryption key quickly, but depending on how many systems were affected it can take weeks to months to get everything working properly again," said Lou Steinberg, founder of CTM Insights. Bloomberg
- CFTC: Cyber rules needed to prevent future system hacks US CFTC Chair Rostin Behnam said in a speech that the cyberattack on ION Trading UK illustrates the need for

new cybersecurity regulations "to preserve the integrity, availability, and confidentiality of critical systems and information." Behnam said that "the industry's necessary and increasing reliance on third-party service providers creates a major source of risk for participants in our markets, a risk that is only promised to rise with growth of virtual access and cloud-computing." BNN Bloomberg (2/3), The Block

Cyber Resilience: Prepare & Protect; A webinar by DLA Piper global cybersecurity team; *2022 witnessed a swathe of headline making cyber-attacks around the world. Ransomware, encryption, and data exfiltration remain some of the most popular methods used by adversaries and no sector or business is immune.*

- In this webinar members of the DLA Piper global cybersecurity practice will share insights on the latest trends in cyber-attacks from around the world. We will consider the importance of cyber assurance and resilience and how organisations should be preparing to protect themselves from the menace of cyber adversaries. We will also provide perspectives on effective incident response and how to manage the consequences of a breach.

CFTC: Cyber rules needed to prevent future system hacks CFTC Chair Rostin Behnam said in a speech that the cyberattack on ION Trading UK illustrates the need for new cybersecurity regulations "to preserve the integrity, availability and confidentiality of critical systems and information." Behnam said that "the industry's necessary and increasing reliance on third-party service providers creates a major source of risk for participants in our markets, a risk that is only promised to rise with growth of virtual access and cloud-computing." BNN Bloomberg

ECB promises proportionate approach to new IRRBB test; But banks still fear regulatory and investor response if many are classed as outliers An overall view: ECB says it will take "current circumstances" into account Samuel Wilkes @wilkkes 09 Feb 2023 Tweet Facebook LinkedIn Save this article Send to Print this page Banks fearing relegation to 'outlier' status under a new supervisory test for interest rate risk might take succour from a suggestion by Europe's largest supervisor that its response will be measured. The new test for interest rate risk in banks' loan and deposit books (IRRBB), devised by the European Banking Authority (EBA), is supposed to identify lenders most at risk from a severe change in rates on the interest spread between banks' assets and liabilities.

PRA PS1/23 – Remuneration: Unvested pay, Material Risk Takers and public appointments; *On 10 February 2023, the PRA published Policy Statement 1/23 'Remuneration: Unvested pay, Material Risk Takers and public appointments' (PS1/23).*

- PS1/23 is relevant to PRA authorised banks, building societies, PRA-designated investment firms, including third country branches, that are subject to the Remuneration Part of the PRA Rulebook. In PS1/23 the PRA provides feedback to the responses to its earlier consultation (Consultation Paper 8/22 'Remuneration: Unvested pay, Material Risk Takers and public appointments' (CP8/22)) and sets out its final policy in the form of an updated version of Supervisory Statement 2/17 – 'Remuneration' (SS2/17).
- In summary, in CP8/22 the PRA proposed a new chapter 4 of SS2/17 covering changes to the instruments or claims that comprise unvested, deferred sums awarded to material risk takers (MRTs) as part of their variable pay. Specifically, the PRA proposed that:
    - In general, unvested, deferred claims that comprise the variable pay of MRTs should not be converted from an equity claim into a claim on other instruments (or vice versa) after an award has been made.

  - This expectation should apply to all unvested, deferred sums, and not exclude amounts above the regulatory minima.
  - In exceptional circumstances, such as where there are potential conflicts of interest arising from a (proposed) public-sector appointment that cannot otherwise be sufficiently mitigated, it may be appropriate for a conversion to occur subject to the prior non-objection of the PRA, and on the basis that the relevant retention requirements remain unchanged.
- Furthermore, the PRA proposed that SS2/17 be amended to outline the circumstances in which it considers it more likely a waiver or modification to the relevant remuneration rules would meet the statutory test under the Financial Services and Markets Act 2000, where, in wholly exceptional circumstances, an adjustment is sought in relation to a public sector appointment with a view to converting an award comprising equity or other instruments to a cash sum.
- In PS1/23 the PRA reports that most respondents welcomed the proposals and is proceeding with them. However, the PRA has made certain modifications to the text of the updated version of SS2/17 in order to provide further clarity. For example, it has added a footnote (number 19) noting that there may, on occasion, be circumstances other than public appointments where a conversion is appropriate. The PRA has also added a line (paragraph 4A.11) to state that in the event of a conflict of interest arising from a public appointment due to instruments being held during a retention period, the onus should be on a public sector employer to determine whether (or not) its conflicts of interest policy is able to address any conflicts.
- In terms of feedback, among other things, the PRA mentions that one respondent noted that firms would require rigorous systems and processes to be able to meet the expectation of making conversions between instruments, or to achieve the circumstances in which a waiver or modification is more likely to be granted. The PRA agrees there are system and administrative implications for those firms that wish to undertake the conversion of unvested, deferred pay from one form into another. However, the PRA is not creating an expectation that firms should undertake conversions for a particular reason. It is for firms to judge whether they wish to do this and approach the PRA to obtain either its non-objection, or to apply for a waiver or modification.
- The new policy takes effect on 10 February 2023.

EBA Final Report: Guidelines to resolution authorities on the publication of the write-down and conversion and bail-in exchange mechanic; *On 13 February 2023, the European Banking Authority (EBA) published a Final Report: Guidelines to resolution authorities on the publication of the write-down and conversion and bail-in exchange mechanic.*

- The Bank Recovery and Resolution Directive provides authorities with the powers to write-down and convert capital instruments, it also sets-out that Member States shall ensure that resolution authorities may apply the bail-in tool to achieve the resolution objectives. Authorities have been working on developing their approaches to exchange mechanic.
- Bail-in is the main tool available to authorities to avoid using taxpayers' money in case of failure of a large bank. It is a complex and largely untested tool. To ensure that authorities' approach is credible and that institutions have the necessary information to prepare, the EBA is asking authorities that have not yet done so to start publishing, from

January 2024, a high-level document setting out the key aspects of their favoured approach. In particular, they are asked to specify if they intend to make use of interim instruments and to set out a timeline of the bail-in process.
- These guidelines provide a clear framework for resolution authorities to publish their approach to using the bail-in too. They are expected to publish a document defining roles of key stakeholder, describe their approach to write down and conversion, whether they intend to use interim instruments or not, and how the share delivery will take place and share a timeline of this process.

Official Journal of the European Union publishes Regulations; *On 13 February 2023, there was published in the Official Journal of the EU (**OJ**), Delegated Regulations extending the cross-border intragroup transactions derogations from margin requirements and from clearing requirements respectively:*
- Commission Delegated Regulation (EU) 2023/314 of 25 October 2022 amending the regulatory technical standards laid down in Delegated Regulation (EU) 2016/2251 as regards the date of application of certain risk management procedures for the exchange of collateral.
- Commission Delegated Regulation (EU) 2023/315 of 25 October 2022 amending the regulatory technical standards laid down in Delegated Regulations (EU) 2015/2205 (EU) No 2016/592 and (EU) 2016/1178 as regards the date at which the clearing obligation takes effect types of contracts.
- Both Delegated Regulations enter into force on the day following that of their publication in the OJ.

Published in the OJ: Commission Implementing Regulation (EU) 2023/313; On 15 February 2023, there was published in the Official Journal of the European Union (**OJ**) Commission Implementing Regulation (EU) 2023/313 of 15 December 2022 amending the implementing technical standards laid down in Implementing Regulation (EU) 2016/2070 as regards the benchmark portfolios, reporting templates and reporting instructions for the reporting referred to in Article 78(2) of Directive 2013/36/EU of the European Parliament and of the Council. This Regulation shall enter into force on the twentieth day following that of its publication in the OJ.

European Commission letter regarding the Call for Advice to the EBA and ESMA for the purposes of the reports on the prudential requirements applicable to investment firms; *On 20 February 2023, the European Commission (**Commission**) published a letter from John Berrigan, regarding the Call for Advice it had issued to the EBA (**EBA**) and the ESMA (**ESMA**) for the purposes of the reports on the prudential requirements applicable to investment firms.*
- The letter notes that in accordance with Article 60 of the Investment Firms Regulation and Article 66 of the Investment Firms Directive the Commission is to submit two reports to the European Parliament and the Council by 26 June 2024. In preparing these reports, the Commission is required to consult with the EBA and ESMA. The Call for Advice sets out the areas where the Commission would welcome the EBA's and ESMA's advice. The EBA and ESMA are asked to deliver this advice by 31 May 2024.

EBA final report on revised guidelines on methods for calculating contributions to deposit guarantee schemes under the Deposit Guarantee Schemes Directive; *n 21 February 2023, the EBA (**EBA**) published a final report containing revised guidelines on methods for calculating*

*contributions to deposit guarantee schemes (***DGS***) under the Deposit Guarantee Schemes Directive (***DGSD***).*

- The DGSD mandates the EBA to develop guidelines on methods for calculating contributions to DGSs and to review them at least every 5 years. During its latest review of the guidelines in 2021-2022 the EBA concluded that several elements of the calculation method needed to be improved. In July 2022 the EBA issued a consultation paper in which it proposed targeted amendments and set out draft revised guidelines. The final report now published sets out the final revised guidelines and feedback from the consultation. The EBA has gone ahead with the amendments proposed in its consultation and also provided further guidance on how to apply a stock-based approach to calculating contributions.
- The revised guidelines apply from 3 July 2024.

EU calls for fast-track crypto capital rules for banks; Tough capital rules for banks holding cryptoassets must be fast-tracked in the European Union's pending banking law if Europe wants to avoid missing a globally-agreed deadline, the bloc's executive has said. The global Basel Committee of banking regulators from the world's main financial centres has set a January 2025 deadline for implementing capital requirements for banks' exposures to cryptoassets such as stablecoins and bitcoin. /jlne.ws/3SfIlyy

Banking package: ECON Committee publishes reports on CRR3 and CRD6; *The EU Parliament's Economic and Monetary Affairs Committee (ECON) has published its reports on the EU Commission's legislative proposals for a directive amending the Capital Requirements Directive (CRD) as regards supervisory powers, sanctions, third-country branches and ESG risk (CRD6) and the proposed regulation amending the Capital Requirements Regulation (CRR) as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor (CRR3).*

- The publication of the reports follows the ECON Committee's vote to adopt them in January 2023.
- The reports have been tabled for the EU Parliament's plenary session.

CRD4: ITS on benchmark portfolios, reporting templates and reporting instructions published in OJ;
Commission Implementing Regulation (EU) 2023/313 amending the implementing technical standards laid down in Implementing Regulation (EU) 2016/2070 as regards benchmark portfolios, reporting templates and reporting instructions under the Capital Requirements Directive (CRD4) has been published in the Official Journal.

- Under CRD4, internal approaches used for the calculation of own funds requirements for market and credit risk are subject to an annual assessment by competent authorities. The Implementing Regulation reflects revisions proposed by the EBA (EBA) in May 2022, and replaces annexes I, II, IV, V and VI to reflect the EBA's proposals for the 2023 benchmarking exercise.
- The Implementing Regulation will enter into force on 6 March 2023.

BRRD: EBA publishes guidelines for resolution authorities on publication of bail-in approach;
The EBA has published guidelines addressed to resolution authorities on the information to be made public on how the write down and conversion will be applied, in particular in the context of the bail-in tool, in accordance with the Bank Recovery and Resolution Directive (BRRD).

- The guidelines are intended to increase consistency and provide a clear framework for resolution authorities to publish a high-level description of their approach to using the bail-in tool, covering:
    - whether they intend to make use of interim instruments or not;
    - an indicative timeline for the application of the exchange mechanic; and
    - how potential valuation adjustments would take place.
- The guidelines apply from 1 January 2024, which is when authorities are expected to start publishing a high-level document. Authorities that have already published information are expected to check that it complies with the guidelines.

ESG & Disclosures

This month, a global ESG development of note was the announcement by the International Sustainability Standards Board (ISSB) of the imminent release of its long-awaited climate and sustainability global disclosure standards, which are set to come into force in early 2024.

- *There were also several ESG highlights from the UK. Litigation was front of mind for many, with the launch of two noteworthy cases by the environmental law charity, ClientEarth: one against Shell's corporate board of directors and another against the UK FCA. On a less contentious note, this month saw a welcome focus on the 'G' of ESG by the UK FCA, which issued a discussion paper (DP) on the role of governance and culture in the management of sustainability related risks and opportunities for financial firms.*

<u>Global Developments</u>

1. World Economic Forum (WEF) Meeting Davos 2023 (multi-sector)

The theme for this year's WEF meeting was "*Cooperation in a Fragmented World*" and given the ongoing war in Ukraine, the global energy crisis continued to be top of mind for world leaders.
A key outcome of WEF was the EU Green Deal Industrial Plan, which some have described as the start of a "subsidies arms race", with the EU looking to compete with the US Inflation Reduction Act. The EU plan has four key pillars: ensuring faster access to green funding; creating a conducive regulatory environment for green growth; closing the green skills gaps and opening trade in support of the transition. The impact of the plan is yet to be seen as it is still under discussion until at least the end of March.
Another highlight concerned the insurance sector: the Net Zero Insurance Alliance published its Net Zero Target Protocol, by which its members have committed to transitioning their insurance and reinsurance underwriting portfolios to net zero greenhouse gas emissions by 2050. Insurers as investors, underwriters and risk managers, play a key role in encouraging the management and mitigation of ESG risk, therefore this Protocol is a pivotal step in the sector's net zero journey.
WEF week is usually accompanied by the publication of numerous market reports and this year was no exception. One publication that received much attention was the Global Risks Report 2023 – which ranks global risks by severity over the short and long term (over a 2-year and 10-year period respectively). Environmental risks appear most concerning as they make up half of the list both for the coming 2 years, as well the coming 10. Some of the risks of highest severity that are not directly categorised as environmental, including the cost of living crisis,

geoeconomic confrontation, and large scale involuntary migration, have already been exacerbated by environmental and climate change-related challenges. Showing the interconnectivity of risks and urgency to act.

Post Davos, the European Securities and Markets Authority (ESMA) issued its "Risk Monitor" which struck a similar tone in its discussion of broad risk and vulnerability trends by zooming in on specific sustainable finance risks, like greenwashing and product labelling.

2. IFRS ISSB Sustainability and Climate Reporting Standards update (financial institutions)

What: The ISSB announced on 17 February that its long anticipated sustainability and climate global reporting standards are to be released by the end of Q2 2023 and take effect in 2024. The announcement also noted that the European Sustainability Reporting Standards (ESRS) will be included in the appendix to the general sustainability reporting standard ("S1") as a source of guidance for companies, in the absence of specific ISSB standards. The first set of draft ESRS were released in November 2022 and will form a part of the EU's upcoming Corporate Sustainability Reporting Directive (CSRD) disclosure regime. Prior to the release of the new reporting standards, the ISSB will focus its efforts to build capacity to ensure the standards can be implemented globally. We will continue to watch this space closely for further developments.

3. Continued complexity within carbon credit markets - and a solution (multi-sector)

What: We have supported Climate Solutions in producing an introductory guide to carbon markets, in order to create one central resource to help readers understand the fascinating world of carbon markets.

Carbon markets play a critical role in combatting the climate crisis as they support countries and companies to reduce their emissions by trading emissions/offsets in return for credits, as part of their wider carbon reduction and net zero strategies. In January, a Guardian article called into question the effectiveness and validity of carbon credits. The article revealed that more than 90% of rainforest carbon offsets issued by Verra, were likely to be "phantom credits", exaggerating the level of emission reductions actually achieved. Verra approves three out of every four voluntary offsets globally hence the article sparked great debate and confusion around carbon credits.

Admittedly this is a complex topic. For example, there are three carbon markets: mandatory/compliance carbon markets, voluntary carbon markets, and the sovereign carbon markets. As such, not all carbon credits are the same. This is why we decided to create a primer to help you better understand this nuanced subject. We believe that our introductory guide to carbon markets is an excellent starting to point to develop the knowledge required.

Looking ahead: Given the news surrounding Verra credits, there has been increasing demand to regulate voluntary carbon markets to improve the quality and credibility of the market. It is also likely that carbon credit buyers will look to diversify the types of carbon credits they purchase.

EU Developments

1. French Regulator proposes minimum sustainability criteria for SFDR funds (asset managers)

What: On 10 February the French regulator, *Autorité des marchés financiers* (AMF) published the position paper on proposed minimum sustainability criteria for Article 9 and Article 8 funds under the EU SFDR and an accompanying press release on 13 February. The AMF's action picks up on one of the topics that has long been discussed in the market, which is that the EU might bring in a set of minimum sustainability criteria to address the issue that the SFDR, even though it is a disclosure regime, is being used by investors as a labelling regime.

The paper proposes:

- Minimum environmental criteria should be established for the classification of products as Article 9 or Article 8. Compliance with these criteria would be subject to national

supervision. The criteria for Article 9 should continue to be more stringent than those for Article 8.

- A minimum proportion of portfolio assets for Article 9 funds should consist of investments aligned with the Taxonomy. This percentage could increase over time as the European economy advances towards sustainability.
- Financial market participants that manage Article 8 and Article 9 funds should adopt a binding ESG approach in their investment decision-making process. The EU framework for minimum criteria should identify a set of acceptable ESG approaches that can be implemented by financial players.
- Article 9 funds should exclude investments in fossil fuel activities that are not aligned with the Taxonomy. Investment in such activities would be possible for Article 8 products provided that they meet strict conditions that ensure that these activities are engaged in an orderly transition.
- In a more exploratory approach, the AMF also proposes to introduce the concept of transition and engagement policies. It has identified possible avenues for a quantitative definition of assets in transition.

Looking Ahead: As a position paper, it has no legal or regulatory status, not even as a form of guidance, but it is indicative of some of the approaches that the EU could consider. It is worth noting that the AMF did state in their press release that they had discussed this with the Commission prior to publication – as we wait for the Commission to respond to some key interpretative questions on SFDR it will be interesting to see whether the AMF's position paper has any impact.

2. In other SFDR news (asset managers):

- The Level 2 SFDR RTS have been updated to take into account amendments regarding fossil gas and nuclear activities, with effect from 20 February. The amendments to the SFDR Level 2 RTS brought about as a result of the Complementary Delegated Act (CDA) under the EU Taxonomy, which covers fossil gas and nuclear activities, have now been published in the Official Journal - they come into effect on the third day following publication. Learn more here.
- The *Commission de Surveillance du Secteur Financier* (CSSF), the financial regulator in Luxembourg announced on 1 February the intention to launch a data collection exercise for investment fund managers (IFMs) related to SFDR. IFMs captured are required to complete a questionnaire on their organisational arrangements via a "SFDR-IFM disclosures" digital module and the deadline for submission is 2 March. There will be future calls for further information to collect data from Principal Adverse Impact (PAI) statements and data within precontractual and periodic disclosure templates. Be sure to keep an eye on developments as further details on the timing and practical procedures for data collection will be announced at a later date.

3. European Commission renewable hydrogen rules (multi-sector)

What: This month the European Commission adopted two Delegated Acts required under the Renewable Energy Directive, defining what it considers as renewable hydrogen and what can be counted towards a Member State's renewable energy targets. Hydrogen production requires significant energy consumption. Therefore there were questions surrounding how to prevent hydrogen from putting a strain on scarce renewable energy resources and on energy prices.

One of the Delegated Acts defines under what conditions hydrogen can be classified as "Renewable Fuels of Non-biological Origins" (RFNBOs) and clarifies that where production is not from a dedicated renewable sources, then the principle of additionality comes into play. Hydrogen production must be matched by additional renewable energy production on an hourly

basis by 2030 and until then on a monthly basis, which incentivises an increase in renewable energy available on the grid. The phased in approach gives time for the hydrogen market in the EU to grow. The additionality rule contains an exemption for countries with a low-carbon electricity mix that can show that production power came from renewable sources.

UK Developments

1. FCA's Discussion Paper on firms' sustainability-related governance (financial institutions)

What: On 10 February, the FCA published Discussion Paper (DP23/1), which opens an industry-wide dialogue on financial services firms' sustainability-related governance, incentives, and competence arrangements. As the feedback to the DP will influence the FCA's regulatory approach and supervisory engagement with firms, it will be of interest to regulated firms across the financial services sector.

The DP seeks industry feedback on a number of issues, most notably for firms (and their senior management):

- whether there is a need to introduce additional regulation to extend individual responsibility for sustainability-related matters to senior management and whether to set specific expectations around the roles and responsibilities of governing bodies, such as fund boards;
- appropriate metrics and weights for linking remuneration to sustainability goals and what adjustments should be made when targets are not met;
- additional regulatory measures that could be introduced to encourage effective stewardship of assets and to direct stewardship efforts towards the most pressing systemic issues; and
- introducing additional training and competence expectations within existing rules or guidance.

Read our summary of the DP here.

Our view: The DP emphasises that it is important for financial services firms to keep pace with the increased regulatory focus on sustainability. Therefore, firms should consider reviewing their sustainability-related governance, incentives, and competence arrangements to ensure that they continue to be fit for purpose and take into account evolving best practices and regulatory expectations. Given the DP's wide application, we also strongly encourage impacted firms to consider responding to the DP either directly or through industry groups.

Timing: The deadline for responses to the DP is 10 May 2023.

2. Shell's board of directors sued over its net zero transition (multi-sector)

What: ClientEarth has now filed its claim against the directors of Shell alleging that Shell's current strategy to meet the targets set in the Paris Agreement and its transition to net zero is in breach of the directors' duties under the Companies Act 2006. ClientEarth brings the claim as a shareholder of Shell and with the support of a large group of other shareholders including large pension funds and other institutional investors. ClientEarth wants to compel the 11-director board "*to act in the best long-term interests of the company by strengthening its climate plans*".

ClientEarth announced its intention to launch the claim in March 2022 (see our update here for more details), following the ruling by the Hague District Court ordering Shell's then Dutch parent company to amend its corporate policy to reduce its emissions. This case breaks new ground in that it is the first of its kind in the world to hold corporate directors directly liable for failing to properly prepare their company for the net zero transition.

Looking ahead: Whilst ClientEarth's claim against Shell's directors is relatively novel, we can see similar claims being brought in the future as the number of climate-related cases continues to grow at pace. Campaigners and even shareholders are likely to target the private sector from a

variety of angles including challenges to how well their commitments chime with national and international climate targets, greenwashing, and breaches of corporate law.

3. ClientEarth launches claim against the UK Financial Conduct Authority (FCA) over its approval of environmental disclosures (multi-sector)

What: ClientEarth strikes yet again – this time filing a judicial review case against the FCA, seeking a declaration from the High Court that the FCA's approval of a prospectus by oil and gas operator and producer, Ithaca Energy PLC, was unlawful and in breach of the Prospectus Regulation. The action alleges that Ithaca's prospectus fails to adequately describe the climate risks associated with the company's activities, which includes part ownership of the Cambo and Rosebank oil and gas fields in the North Sea.

ClientEarth alleges the following three deficiencies with Ithaca's prospectus, which it argues are vital to allow investors to make an informed assessment of the company's financial position:

1. The risks disclosed in Ithaca's prospectus are too general in nature to leave investors fully informed or to meet the Prospectus Regulation requirements;
2. The prospectus does not address the apparent conflict between Ithaca's intention to develop new fossil fuel assets and the International Energy Agency's conclusion that no new fuel fossil fuel infrastructure can be built if the world is to meet a 1.5 °C warming target; and
3. The prospectus fails to explain how the company's business model and financial prospectus would need to change, or be affected, if the Paris Agreement goals are to be achieved and what impact that would have on their key assets.

Looking ahead: The very fact that ClientEarth has attempted to bring an action will focus the minds of companies, their advisers and the regulator to the nature of ESG disclosure in prospectuses and other public disclosure. Further, if ClientEarth is successful, this may embolden other stakeholders to pursue litigation in connection with ESG disclosures by listed companies. We will update you as this claim progresses, including whether the High Court grants permission for ClientEarth to bring the claim.

4. High Court rejects judicial review challenge against UK Government for failing to halt imports of cotton allegedly produced with forced labour in China (multi-sector)

What: The High Court has rejected an action brought by Global Legal Action Network (GLAN) and the World Uyghur Congress (WUC) against UK Government enforcement authorities for failures to investigate breaches of the Foreign Prison Made Goods Act 1897 (FPMGA) and the Proceeds of Crime Act 2002 (POCA) arising in connection with the import of Uyghur forced and prison labour cotton from Xinjiang, China.

GLAN and WUC relied on the evidence of widespread prison labour in Xinjiang to assert that at least *some* of the cotton imported into the UK had been manufactured in a foreign prison, contrary to FPMGA. Under POCA, GLAN and WUC asserted that the imported cotton represented a benefit from criminal conduct, with its acquisition, use or possession by any UK person being a money laundering offence.

The Court rejected these arguments since there was no evidence that linked a specific consignment of cotton to either prison or forced labour. In relation to the POCA argument, the Court also held that, given the availability of an adequate consideration defence, a successful prosecution required evidence that the consignment had been purchased at a significant undervalue. A particular challenge in the context of a lengthy international value chain, since the chain could be broken by any payment for market value in any of the transactions involved.

However, although the Court rejected these claims, it emphasised the judgment did not undermine the "*striking consensus in the evidence that there are clear and widespread abuses in*

the cotton industry in [Xinjiang]", and that other legal tools or further evidence may come to light which could meet the required thresholds.

Looking ahead: This confirmation of the high evidential threshold for investigating and prosecuting criminal offences linked to prison and forced labour will provide some reassurance to businesses with cross-border supply chains in the garment industry and other higher risk sectors, and those who finance them. However, in light of increasing focus from multiple stakeholders on modern slavery risks, businesses will need to pay continued close attention to their financial crime risks and obligations.

Middle East Developments

1. Saudi Exchange announces trilateral MoU to help implement ESG framework in Saudi Arabia

What: At the Saudi Capital Market Forum held in Riyadh on 11 February, the CEO of the Exchange, Mohammed Al-Rumaih, announced that the Saudi Tadawul Group (which operates the Saudi stock market) has signed a trilateral memorandum of understanding with the Saudi Capital Market Authority and the Ministry of Planning and Economy to assist the three partners in implementing an ESG framework in the Saudi Capital Market. Al-Rumaih noted that "*ESG is very strategic to us. This is one of the areas that have witnessed the best growth*" adding that the Saudi Exchange expects 30% of its listed companies to make ESG disclosures this year.

2. New Dubai Virtual Assets Regulatory Authority (VARA) Regulations

What: On 7 February, new licensing regulations were introduced by VARA, the regulator of virtual asset activities in the Emirate of Dubai (excluding the financial free zone of the Dubai International Financial Centre). Notably, the Regulations contain disclosure requirements related to ESG issues, which makes VARA the first regulator in the UAE to impose ESG disclosure requirements specifically on virtual asset service providers.

Under the Regulations, when a virtual asset service provider (VASP) applies for a licence, VARA would determine which of three ESG disclosure levels applies to them, taking into account factors such as the size and business model of the VASP and its group. These three ESG disclosure levels are: 'Voluntary ESG Disclosure', 'Compliance ESG Disclosure' and 'Mandatory ESG Disclosure'. The Mandatory ESG Disclosure is the most onerous and would require a VASP to establish practices and procedures to raise awareness of ESG-related activities and opportunities; publish an annual ESG report disclosing and publicise information on its D&I initiatives prominently on its website.

Other notable ESG-related requirements in the Regulations include the need to publicly state the use of renewable energy and initiatives relating to decarbonisation and emission reduction when conducting mining or staking activities, regardless of a VASP's ESG disclosure level; and the need to consider ESG issues when selecting service providers (e.g., VASPs should be satisfied that the service provider acts in an ethical and socially responsible manner). Such regulations are encouraging in terms of fostering a more ESG-friendly landscape in the UAE and for virtual asset service providers.

3. UAE Securities and Commodities Authority introduces new categories of specialised funds, including ESG funds

The Securities and Commodities Authority (the SCA) of the United Arab Emirates has recently made numerous changes to the funds regime applicable in 'onshore' UAE (i.e. excluding the Abu Dhabi Global Markets and Dubai International Financial Centre financial free zones). Amongst the recent changes, on 16 January, the SCA introduced a series of new specialist funds, such as ESG funds whose investment portfolio and/or fund strategy shall comply with ESG criteria to be set out in the fund's prospectus. With its new regulations, the SCA aims to boost the number of local funds.

Asia Developments

1. Monetary Authority of Singapore Disclosure Guidelines for Retail ESG Funds

What: On 3 January, the Monetary Authority of Singapore (MAS) issued FAQs on the circular CFC 02/2022 Disclosure and Reporting Guidelines for Retail ESG Funds that was issued on 28 July 2022. The Circular sets out the MAS' expectations on how existing requirements under the Code on Collective Investment Schemes and the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations apply to retail ESG funds and the FAQs further clarify these expectations. You can read more about this in our summary of these FAQs here.

2. ISDA Publication: Regulatory Framework for Sustainability-Linked Derivatives (Singapore)

In early February, ISDA published their paper on the Regulatory Framework for Sustainability-Linked Derivatives in Singapore. The paper is the equivalent for Singapore of ISDA's December 2021 whitepaper, on Regulatory Considerations for Sustainability-linked Derivatives (SLDs), which explored regulatory issues for SLDs in the UK, EU and US. This paper considers whether SLDs in Singapore would be classified as over-the-counter derivatives transactions or another type of regulated product, how they are regulated and compliance issues for market participants to consider when executing SLDs.

ESG Consultation round-up

Some notable ESG policy consultations in flight across the globe that are currently open for comment. Such engagement is a great opportunity to influence the direction of travel for ESG matters.

1. ASCOR Consultation to assess sovereign debt issuers on climate change (financial institutions)

What: On 7 February, Assessing Sovereign Climate-Related Opportunities and Risks (ASCOR) launched a consultation report on the first public investor framework to assess sovereign bond issuers on climate change. The framework sets out a common basis to assess individual country climate change approaches and will reinforce public disclosures to aid investors to understand sovereign action and progress. The consultation aims to engage with sovereign bond issuers, development finance institutions, investors, civil society and the wider public. It welcomes feedback on the principles underpinning the framework, on the proposed indicators, and methodology, as outlined in the report.

Timing: ASCOR will be running public webinar and regional roundtables in February and March 2023 to engage with stakeholders. The consultation closes on 31 March 2023.

2. European Commission Consultation on product categories under proposed Ecodesign for Sustainable Products Regulation (multi-sector)

What: On 1 February, the European Commission published a public consultation seeking views on the categories of new products and measures that the proposed Ecodesign for Sustainable Products Regulation (ESPR) should prioritise. It focuses on products and measures that are not currently within the scope of the Ecodesign Directive (2009/125/EC) (which only covers energy-related products).

The draft ESPR aims to make products sold in the EU, including end-use products like textiles, furniture, toys, as well as intermediary products like iron, steel and plastics, subject to performance and information-related requirements, to ensure greater sustainability. It includes a framework for setting ecodesign requirements based on multiple criteria including durability, circularity, use of substances of concern, energy efficiency and carbon footprint. The ecodesign

requirements will be set on a product-by-product basis, or on the basis of groups of products with enough similar characteristics.
Timing: The consultation closes on 25 April 2023 and the Commission is aiming to adopt a communication in Q1 of 2024.

3. UK HMT consultation and call for evidence on the regulation of cryptoassets

What: On 1 February, the HM Treasury published a consultation setting out its proposal for the future regulatory regime for cryptoassets, including a chapter on sustainability and cryptoassets. The objective of the proposal is to establish a proportionate and clear regulatory framework which enables firms to innovate at pace, while maintaining financial stability and clear regulatory standards. The call for evidence specifically relating to sustainability, asks:

- What information regarding environmental impact and / or energy intensity would investors in cryptoassets find most useful for their decisions?
- What reliable indicators are useful and / or available to estimate the environmental impact of cryptoassets or the consensus mechanism which they rely on? And what methodologies could be used to calculate these indicators?
- How interoperable would such indicators be with other recognised sustainability disclosure standards?
- At what point in the investor journey and in what form, would environmental impact and / or energy intensity disclosures be most useful for investors?
- Will the proposals for a financial services regulatory regime for cryptoassets have a differential impact on those groups with a protected characteristic under the Equality Act 2010?

Timing: The consultation closes on 30 April 2023.
Recent publications: on ESG

- ESG – SFDR RTS changes on fossil gas and nuclear activities published (17 February 2023)
- ESG: FCA opens discussion on governance, incentives and competence (13 February 2023)
- Carbon Markets: An introductory guide (9 February 2023)
- ESG: UK SDR – Simmons responds to the FCA's consultation paper (25 January 2023)
- European energy regulation overview (24 January 2023)
- Oversight: FAQs on disclosure and reporting guidelines for ESG funds (10 January 2023)

FTT, FATCA & Taxation
Spain's biggest banks prepare to challenge windfall tax; Lenders say they will make the first payment due next month but are ready for legal action; Spain's biggest banks will challenge the country's controversial windfall tax after they have made the first payment next month, according to people familiar with their plans. The levy was proposed last summer by Spanish prime minister Pedro SÃ¡nchez to raise EUR3bn to cushion people from surging energy prices. Several other European governments have targeted the profits banks have made from rising interest rates. But Spanish lenders have decided to challenge the tax authorities after paying their first instalment by February 20. /jlne.ws/3DsuYum

OECD provides guidance on global tax deal; The Organization for Economic Cooperation and Development has offered guidance on implementation of a global tax deal that affects companies, including how the measures being put in place in other countries will interact with the US tax system. The US helped to gain international support for the deal, but has been unable to get the tax agreement through Congress. Reuters The Wall Street Journal

FIA calls for supportive carbon market derivatives rules The FIA has responded to an International Organization of Securities Commission carbon market consultation by calling for compliance and voluntary global carbon markets to be handled through existing rules, rather than developing broad new guidelines. FIA says IOSCO should be deliberate in determining whether the existing carbon markets structure avoids inhibiting the growth of derivatives on carbon credits. Futures & Options World

Dec 23 EUA 93.60

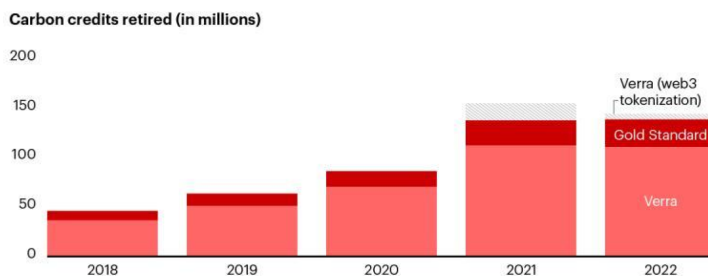
The European parliament convincingly voted in favour of RePowerEU act on Tuesday afternoon. 535 members of the parliament voted in favour of 300 billion EUR worth package, 53 abstained, while 63 voted against suggested legislation. *In order to accelerate transition and exit from Russian and general fossil fuel dependency, EU proposed such package to ensure sufficient funding that is needed.*

- Funding will be secured from several sources, most controversial being EUA sales from Market Stability Reserve, as such mechanism could severely impact prices mid and long-term. Before additional supply translates into bigger volumes on auctions, member states will have to agree with additions as well. The amount coming from EUAs would total 20 billion EUR. After the news has been published, EUAs fell sharply. Despite obvious move by EU to flood market with additional supply, carbon remains well balanced if not supported.
- At the time of writing, EUAs reverted the whole move from yesterday and is eyeing 95 EUR again. Compliance buyers are slowly running out of time to purchase allowances for year 2022 and their activity could certainly fuel EUAs to go higher, especially since buying will take place in so short time frame. Additionally, winter seasons have been historically supportive of EUAs and it should as no surprise if carbon reaches new all-time highs in coming weeks.
- German power prices are down by 2.25 EUR since last week, with the front year contract trading at 161.25 EUR/MWh. API2 coal prices are up by 10.00 USD since last week, with the Cal24 contract trading at 135.00 USD/tonne. EUR/USD is down by 50 points since last week and is currently trading 1.0680.

Carbon Markets; Bain & Company has published a brief setting out the outlook in 2023 for voluntary carbon markets.

- If 2021 elevated optimism in voluntary carbon markets (VCMs), then 2022 brought some of those expectations down to earth.

- Carbon markets are at an inflection point: Either the uncertainties will be resolved through cooperation by participants and regulators, leading to yet more growth, or markets will become bogged down by poor alignment and confusion. The latter course could cause many potential buyers to wait for greater clarity, thus slowing the growth of VCMs and limiting the potential of this important tool in the fight against the climate crisis.
- A look at the market dynamics of 2022 and the outlook for 2023 provides some insight to corporates navigating the VCMs and hoping to capitalize on the opportunities within them.
- *VCMs grew rapidly over the past five years, but that growth has begun to slow over the past year.
- *The uncertainty roused by shifting policies and concerns about the eligibility of some credits may have led some potential purchasers to adopt a wait-and-see posture.
- *To spur growth, carbon markets proponents will likely push for consistent and clear global standards that afford greater confidence to market participants.



Published in the OJ – Commission Delegated Regulation (EU) 2023/363; On 17 February 2023, there was published in the Official Journal of the European Union (OJ) Commission Delegated Regulation (EU) 2023/363 of 31 October 2022 amending and correcting the regulatory technical standards (RTS) laid down in Delegated Regulation (EU) 2022/1288 as regards the content and presentation of information in relation to disclosures in pre-contractual documents and periodic reports for financial products investing in environmentally sustainable economic activities. Among other things, the Delegated Regulation incorporates nuclear and gas disclosures into the RTS set out in Delegated Regulation (EU) 2022/1288. It also deals with two changes that the European Supervisory Authorities previously noted concerning erroneous cross-references in the periodic disclosures. The Delegated Regulation enters into force on the third day following its publication in the OJ.

Scientists studying Antarctica's vast Thwaites Glacier - nicknamed the Doomsday Glacier - say warm water is seeping into its weak spots, worsening melting caused by rising temperatures, two papers published in Nature journal showed Thwaites, which is roughly the size of Florida, represents more than half a meter of global sea level rise potential.

Avian flu has reached new corners of the globe and become endemic for the first time in some wild birds that transmit the virus to poultry, according to veterinarians and disease experts, who warn it is now a year-round problem. They said the prevalence of the virus in the wild signals that record outbreaks will not abate soon on poultry farms, ramping up threats to the world's food supply.

Planning for the Transition – UK Taskforce Consults on New Transition Plan Disclosure Framework; *On 8 November 2022, the UK's newly established Transition Plan Taskforce (TPT) launched its proposed disclosure framework for "gold-standard" net-zero transition plans.*

- Established shortly after COP26, the TPT is a UK Government-mandated body which was tasked with developing a standard for transition plans that encourage best practice among UK

companies. Its purpose is to support the UK's 2050 net-zero pledge by ensuring that companies demonstrate greater transparency as to how they will decarbonise.

Europe's Carbon Price Hits a Record 100 euros as Economy Rebounds From Energy Crisis; Economic outlook helps drive cost of permits to a record high; Price rally may renew concerns among industry, governments; The cost of European pollution permits rose to 100 euros ($106.59) for the first time, boosted by an improving economic outlook and expectations of a rebound in industrial output. Demand for the carbon contracts is building in anticipation that plunging natural gas prices may prompt some industrial companies to revive production that was curbed or shuttered last year by rocketing energy costs. At the same time, the prospect of tougher climate rules means pollution rights may be in shorter supply, deterring market participants with surplus allowances from selling them. /jlne.ws/3XPWEk0

https://soundcloud.com/user-649259350/labours-five-missions?utm_source=clipboard&utm_medium=text&utm_campaign=social_sharing

Dec 23 EUA 96.60

For the first time in EU ETS history, December 2023 futures contract breached triple digits on the back of persistent buying activity that has been going on for the past few weeks. *EUAs have been in a bullish trend for the better part of this year, without any greater pullbacks, despite confirmed frontloading of emission allowances sales in mid-term. EUAs will be sold in value of 20 billion euros, which will be used for transition away from Russian fossil fuels.*

- The EU Council has adopted the suggested REPowerEU proposal, however the exact calendar of increased auctions and the volumes is still unknown. So far, market has not reacted negatively to the published news, suggesting that timing of sales would be more important to determine short term prices. A factor that might be also affecting bullish narrative in carbon prices, could be selling of power and production hedging. With coldest part of the winter behind us, risk of energy prices spiking extremely has waned, therefore incentivizing power producers to sell their power forward and buy EUA in tandem. EUAs have been well supported by consistently strong auctions and good participation, despite high absolute prices. EUA spot prices, however, fell short of all-time highs, reached during halved auctions in August 2022.
- Reason for this is that cost of carry jumped up significantly in comparison to last year and is at the moment higher than three percent per annum. In previous years the difference between spot and futures prices was much lower. With further interest rate hikes expected from central banks, the spread could widen even further.
- German power prices are down by 8.25 EUR since last week, with the front year contract trading at 153.00 EUR/MWh. API2 coal prices are up by 9.00 USD since last week, with the Cal24 contract trading at 144.00 USD/tonne. EUR/USD is down by 50 points since last week and is currently trading 1.0630.
- EU hits record €100 per tonne for carbon permits The EU's Emissions Trading System saw the price of carbon permits hit a record €100 per tonne, a price viewed as a benchmark that could spark more debate over pricing. Some analysts say the EU's plan to auction more carbon permits could cause a correction in the price. BNN Bloomberg Reuters

ESG – what to expect from financial regulators in 2023 – disclosures, data, and 'greenwashing' in the spotlight; *ESG disclosures, data product and ratings providers and 'greenwashing' will be in the regulatory spotlight in 2023, as financial regulators seek to implement measures aimed at improving the sustainability information made available to investors and to ensure that claims of being 'green', 'climate-friendly' and 'sustainable' stand up to scrutiny.*

- This briefing paper discusses what to expect from financial regulators in 2023.

ISDA responds to ESMA consultation on ESG fund names; *On February 20, ISDA submitted its response to the ESMA's (ESMA) consultation on proposed guidelines on funds' names using environmental, social and governance (ESG) or sustainability-related terms.*

- The response emphasizes that a common cross-industry methodology for the calculation of the minimum proportions of sustainable investments for derivatives transactions is paramount to achieve ESMA's policy goal of promoting standardized disclosures and calls on ESMA to give the industry sufficient time to form a consensus on the calculation thresholds for derivatives.
- ISDA further points to the inconsistent treatment of derivatives within the Sustainable Finance Disclosure Regulation (SFDR) at product/fund level and askes ESMA to take derivatives into consideration in funds' taxonomy ratios based on their underlying, and in a consistent manner in the numerator and the denominator of the relevant key performance indicators also in the context of the upcoming SFDR review.
- The response also highlights that derivatives whose underlying are companies' equity and debt contribute to sustainability objectives/ESG characteristics proportionately to the exposure they offer to their underlying and should therefore be included in threshold calculations based on this exposure, and their underlying assets' sustainability/contribution to ESG characteristics.

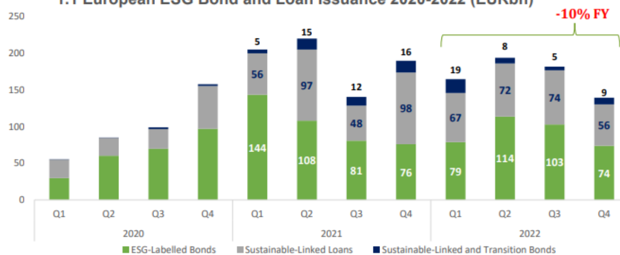
ICE Announces Plan to Expand its Climate Risk Offering Globally with Dun & Bradstreet Supply Chain and Location Data; to leverage its global supply chain and corporate location data to expand ICE's climate risk offering globally. By leveraging Dun & Bradstreet's supplier network and location data, ICE plans to expand its geospatial data and intelligence platform globally, which can enable multi-asset class climate risk analysis for private and public companies, sovereigns, and real estate portfolios around the world. With the expansion, ICE will be able to provide climate metrics on more than four million unique fixed income securities globally. /jlne.ws/3XQY11R

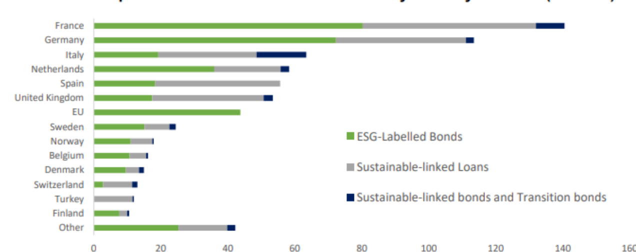
Analysis: U.S. Financial Firms Need New Narrative to Combat Upcoming Political Battles over ESG "We think that banks should be non-political. Banks should not be a political party," says Kentucky lawmaker Andy Barr. Henry Engler, Senior Editor, Regulatory Intelligence at Thomson Reuters, points out the allegations are not new. They follow an onslaught of recent attacks and efforts by Republican state attorneys general to exclude banks and asset managers from underwriting municipal securities and other financing activities because of their perceived discriminatory ESG policies. More

[AFME has published its European ESG Finance quarterly data report for the fourth quarter of 2022 and full year 2022](). *The report has found that European ESG bond and loan issuance has declined by 10% in 2022, which was predominantly driven by lower social bond issuance.*

- Green bond issuance grew 6% in 2022, notwithstanding the wider market turbulence of the year, while social bond issuance declined 40% in full year 2022.
- Moreover, sustainable bond issuance declined by 12% full year, which is of similar proportion than the wider market contraction in non-ESG bonds during the year. Sustainable-linked bonds declined 16% in 2022 notwithstanding a quarterly record amount in Q1'22.
- ESG securitisation issuance declined from €8bn in 2021 to €1.2bn in 2022.

afme/ Finance for Europe **Key findings**





In Q4'22, European ESG bond and loan issuance accumulated a total of €155bn in proceeds, bringing the total annual issued amount to €680bn in 2022.

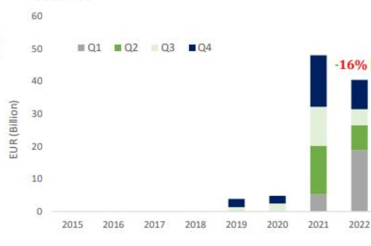
ESG bonds and loans include ESG-labelled bonds (proceeds-based), sustainable-linked bonds, transition bonds, green-linked loans and sustainable-linked loans.

The total supply of ESG bond and loan issuance declined 10% FY, predominantly driven by lower social bond issuance.

French issuers continued to lead in total ESG bond and loan issuance, followed by German issuers.

ESG securitisation issuance declined from €8bn in 2021 to €1.2bn in 2022.

afme/ Finance for Europe **Key findings**



ESG-labelled bond issuance which comprises Green, Social and Sustainable bonds, accumulated €68bn in proceeds in Q4 2022 (€369bn FY).

Green bond issuance stands out as the ESG sub asset class that grew the most during the year, accumulating an increase of 6% FY, while a decline was visible in Social and Sustainable bond issuance. The increase in green bond issuance has been driven by the corporate sector, with a 15% FY increase. The sovereign sector has continued to participate in the green bond market, with Austria and Denmark originating inaugural green sovereign bonds during the year and the continuation of green bond programmes by the EU and some European sovereigns.

Social bond issuance accumulated a decline of 40% in 2022FY. The strong participation of the French agency CADES did not offset the contraction in EU Commission Social bond issuance.

Sustainable bond issuance declined 12%FY, which is of similar proportion than the wider market contraction in non-ESG bonds during the year.

Sustainable-linked bond issuance saw a quarterly increase in Q4'22 after a slowdown in the previous two quarters. Despite the record Q1'22 issuance, total FY issuance declined 16% as the subsequent quarters recorded significantly lower issuance compared to 2021.

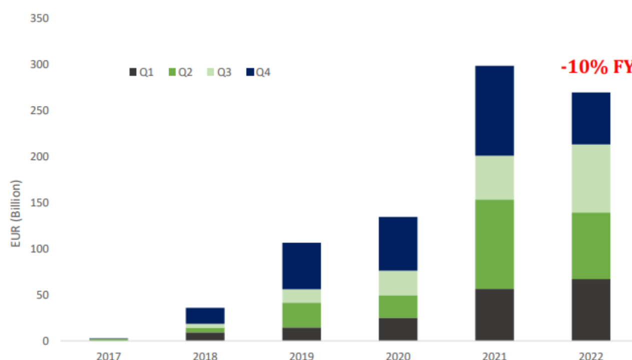
Top single ESG bond issues by amount in 2022 FY

Environmental	Amount (EUR)	Maturity date	ISIN
European Union	6.0	04-Feb-43	EU000A3K4DG1
Italy	6.0	30-Apr-35	IT0005508590
European Union	6.0	04-Feb-33	EU000A3K4DW8
United Kingdom	5.0	31-Jul-53	GB00BM8Z2V59
European Union	5.0	04-Feb-48	EU000A3K4DM9
State of the Netherlands	5.0	15-Jan-40	NL0013552060
Social	**Amount EUR (bn)**	**Maturity date**	**ISIN**
European Union	6.5	04-Dec-37	EU000A3K4D09
CADES	6.0	19-Jan-32	FR0014007RB1
CADES	5.0	25-May-32	FR001400A3H2
CADES	5.0	25-Nov-32	FR001400CVE3
CADES	5.0	25-May-27	FR001400DZI3
CADES	4.1	02-Nov-25	US12802D2K12 XS2551365773
Sustainability	**Amount (EUR)**	**Maturity date**	**ISIN**
European Investment Bank - EIB	4.0	15-Nov-27	US298785JT41
North Rhine Westphalia	2.0	15-Jun-32	DE000NRW0NF8
BNG	1.8	12-Jan-32	XS2430965538
Agence Francaise de Developpement - AFD	1.5	25-May-32	FR001400ADF2
North Rhine Westphalia	1.5	14-Jun-52	DE000NRW0NG6
Action Logement Services	1.3	13-Apr-32	FR0014009N55

During 2022, the sovereign sector originated the largest single green issues with deal amounts of €6.5bn to €5bn.

The French Caisse d'Amortissement de la Dette Sociale (CADES) continues to consolidate as a market leader for social bonds.

1.7 European sustainability-linked and Green-linked Loan Issuance 2017-2022



Sustainability-linked and green-linked loan origination accumulated a decline of 10% in 2022FY, with €270bn in proceeds during the year.

Sovereigns should embrace KPI-linked social and biodiversity bonds; by Burhan Khadbai 22 February 2023; Latin America is trailblazing in the ESG bond market

- Sovereigns from the Latin American region have been at the forefront in the innovation of the environmental, social and governance bond market. They could be set to bring further creativity to the market with biodiversity-labelled bonds and bonds with key performance indicators linked to social causes.
- 'In the same ways we've seen social and the use-of-proceeds side from Latin America being an important area, I do think we're going to see some development on that in the sustainability-linked space,' said Richard Sanders, director of sustainable and positive impact finance at Societe Generale. Sanders was speaking at the virtual Latin America and Caribbean public sector debt outlook event hosted by OMFIF's Sovereign Debt Institute.
- 'I also think that Latin American sovereign issuers as a whole have an opportunity in biodiversity… so I would like to think that we're going to see some issuance in that space as well,' added Sanders.
- Latin America has led the way in introducing social bonds and sustainability-linked bonds for sovereign issuers. Ecuador brought the world's first sovereign social bond in 2020 before Chile brought the world's first sovereign SLB last year.
- Biodiversity bonds are also gaining in interest, with the World Bank issuing its so-called 'rhino bond' last year. Investors in that bond will not receive coupon payments – the World Bank will instead make conservation investment payments to finance rhino conservation activities.

Meanwhile, the International Finance Corporation has added biodiversity projects to its green bond framework to allow it to fund projects in this area.
- 'There's been a tremendous amount of interest from the Latin America region,' said Peter Borgesi, vice president, debt capital markets at Societe Generale, on sovereign social KPI-linked and biodiversity bonds. 'A number of other regions have also expressed a significant amount of interest in both of these categories. The debate continues about what is most appropriate for each country and, in many cases, use of proceeds is more relevant or the right option versus KPI-linked securities.'
- Sovereign SLBs have not really taken off since Chile and Uruguay sold the first such bonds last year. However, Costa Rica is planning to issue SLBs as it looks to make its debut in the ESG bond market in 2023. Meanwhile, Ghana has developed an ESG bond framework which includes the issuance of SLBs. But there are no signs of developed market sovereigns issuing in this area despite growing interest in the product.
- 'One of the big issues with SLBs is… the idea that the KPIs have to be a substantial departure from business as usual,' said Alfredo Mordezki, head of Latam fixed income at Santander Asset Management. 'So issuers have to be very ambitious on their sustainability performance targets. That was the idea when it was created. It's quite difficult for us as investors looking at many different names and many different industries to really understand if this target is a substantial departure from business as usual or if it's not.'
- Mordezki commended Chile and Uruguay for their SLB transactions as they linked their KPIs to nationally determined contributions, which he said is 'a big departure from business as usual'.
- Brazil, however, will not opt for an SLB format for its debut ESG issuance. 'We are leaning towards sustainable bonds – green plus social – and a use-of proceeds-format,' said Otavio Ladeira de Medeiros, public debt undersecretary at Brazil's national Treasury, adding that they are nearing the end of developing their framework. Brazil has been working on developing an ESG framework with the World Bank and the Inter-American Development Bank, with plans to bring the deal to the external market in 2023 after being absent in 2022 due to volatility.
- De Medeiros said one of the main reasons for issuing ESG bonds was to develop a liquid yield curve to help other Brazilian issuers enter this market. SLBs are not likely to be helpful in this respect due to there being more volatility with SLBs than with use-of-proceeds bonds.
- The sustainable bond framework will give Brazil the flexibility to fund social projects as well as those for the environment, given the lack of projects available for green financing. Some market participants say that a Brazilian green bond would raise 'greenwashing' concerns as Brazil has failed to make progress on its deforestation commitments in relation to the Amazon rainforest.
- Jamaica is also working on a green bond framework – not for its own issuance, but rather for the private sector. 'The Jamaica Stock Exchange and the government are partnering to create a framework and platform for private institutions to issue green bonds starting next year,' said Dian Black, principal director, debt management at Jamaica's ministry of finance. 'The process is far advanced, and they intend to have the regulatory and institutional framework in place by the end of this year so that institutions can issue the green bonds across the stock exchange's platform,' added Black.
- *Burhan Khadbai is Head of Content, Sovereign Debt Institute, OMFIF.*

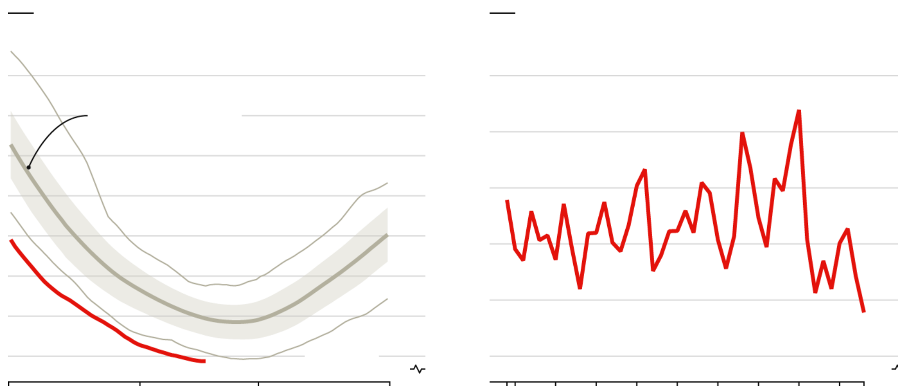
Sustainable finance: Building global consensus to achieve climate goals; *In an increasingly crowded and confusing environment, there is a need for practical, globally applicable solutions for sustainable finance. Tuesday 28 February 2023 16:00 – 19:00 Bloomberg 3 Queen Victoria Street*

- The British Standards Institution (BSI), the UK's national standards body, would be delighted if you could join us for the launch of the new ISO Sustainable Finance Framework standard, hosted by Bloomberg.
- Our speakers are Nigel Topping, the former UN High-Level Climate Action Champion, and Sergio Mujica, Secretary General of ISO. They will be joined by a panel of senior representatives from ISO, IOSCO, UN PRI, BSI and Bloomberg.
- This event will be an opportunity for financial experts to:

- Gain a deeper insight into the current reporting and disclosure landscape.
- Understand how ISO's consensus-based standards can support the new frameworks and complement the work of ISSB, IAASB and IESBA
- Appreciate the benefits of the new sustainable finance framework standard, ISO 32210, and the Net Zero Guidelines as examples of ISO's ability to deliver convergence and a common language
- Registration is from 16.00-16.30. There will be a panel discussion where questions are encouraged from the audience. The event concludes with drinks and networking.
- SPEAKERS
- Welcome
- Cinzia Chiriac, Head of ESG Regulatory Affairs, Bloomberg
- Scott Steedman, Director-General, Standards, BSI
- Speeches
- Nigel Topping, UN Climate Change High-Level Champion at COP26
- Sergio Mujica, Secretary General, ISO
- Panel: How can standards help build practical sustainable finance solutions for the real economy?
- Scott Steedman, Director-General, Standards, BSI – Panel Chair
- Joe Noss, Senior Director, Financial Services, WTW; and Chair, ISO TC 322 Sustainable Finance
- Hayden Morgan, Partner, Head of Sustainability Advisory, Pinsent Masons; and Working Group Convenor, ISO 32210
- Chris Faint, Head of Climate Hub Division, Bank of England
- Louisa Chender, Head of Sustainable Finance, FCA
- Cathrine Armour Chief Reporting Officer, UN Principles for Responsible Investment

Sea ice in Antarctica is at its lowest-ever level, again; *A recent decline of ice around the South Pole worries climate scientists.*

- At the beginning of March 1898 a Belgian research vessel became stuck in the ice of Antarctica's Bellingshausen sea. The *Belgica* and its crew—which included Roald Amundsen, who later became the first man to reach the South Pole—remained there for a year. Scientists aboard *Polarstern*, a German research ship currently in the same place, now have a very different view: earlier this week the expedition leader said he had never seen the sea so devoid of ice. On February 13th sea ice across the Antarctic as a whole spanned 1.91m square kilometres, the lowest level since satellite records began in 1979.



EV (ELECTRIC VEHICLES): "Volkswagen (VW) calculates that a diesel car emits less CO2 than an EV for the first 70,000 miles it is driven. How can this be? Fabricating one EV battery entails mining about 250

tons of rock to secure the minerals needed. The energy used in the mining ecosystem, oil, coal, and natural gas, means that 1 EV has a carbon debt equal to emitting between 8 and 20 tons of CO2 before its first mile driven.

SFDR: RTS on gas and nuclear energy activities published in OJ; *A Delegated Regulation amending regulatory RTS to include the disclosure of investments in taxonomy-aligned gas and nuclear economic activities under the Sustainable Finance Disclosure Regulation (SFDR) has been published in the Official Journal.*

- Delegated Regulation (EU) 2023/363 amends the existing SFDR RTS to align them with the Taxonomy Complementary Climate Delegated Act, which includes specific nuclear and gas energy activities in the list of environmentally sustainable economic activities covered by the EU Taxonomy.
- The amendments are intended as limited adjustments of the existing regulatory framework and include revised pre-contractual and periodic disclosure templates and minor technical revisions.
- The Delegated Regulation entered into force on 20 February 2023.

This month, a global ESG development of note was the announcement by the International Sustainability Standards Board (ISSB) of the imminent release of its long-awaited climate and sustainability global disclosure standards, which are set to come into force in early 2024.

There were also several ESG highlights from the UK. Litigation was front of mind for many, with the launch of two noteworthy cases by the environmental law charity, ClientEarth: one against Shell's corporate board of directors and another against the UK FCA. On a less contentious note, this month saw a welcome focus on the 'G' of ESG by the UK FCA, which issued a discussion paper (DP) on the role of governance and culture in the management of sustainability related risks and opportunities for financial firms.

Global Developments

1. World Economic Forum (WEF) Meeting Davos 2023 (multi-sector)

The theme for this year's WEF meeting was "*Cooperation in a Fragmented World*" and given the ongoing war in Ukraine, the global energy crisis continued to be top of mind for world leaders.
A key outcome of WEF was the EU Green Deal Industrial Plan, which some have described as the start of a "subsidies arms race", with the EU looking to compete with the US Inflation Reduction Act. The EU plan has four key pillars: ensuring faster access to green funding; creating a conducive regulatory environment for green growth; closing the green skills gaps and opening trade in support of the transition. The impact of the plan is yet to be seen as it is still under discussion until at least the end of March.
Another highlight concerned the insurance sector: the Net Zero Insurance Alliance published its Net Zero Target Protocol, by which its members have committed to transitioning their insurance and reinsurance underwriting portfolios to net zero greenhouse gas emissions by 2050. Insurers as investors, underwriters, and risk managers, play a key role in encouraging the management and mitigation of ESG risk, therefore this Protocol is a pivotal step in the sector's net zero journey.
WEF week is usually accompanied by the publication of numerous market reports and this year was no exception. One publication that received much attention was the Global Risks Report 2023 – which ranks global risks by severity over the short and long term (over a 2-year and 10-year period respectively). Environmental risks appear most concerning as they make up half of the list both for the coming 2 years, as well as the coming 10. Some of the risks of highest severity that are not directly categorised as environmental, including the cost-of-living crisis, geoeconomic confrontation, and large-scale involuntary migration, have already been exacerbated by environmental and climate change-related challenges. Showing the interconnectivity of risks and urgency to act.
Post Davos, the ESMA (ESMA) issued its "Risk Monitor" which struck a similar tone in its discussion of broad risk and vulnerability trends by zooming in on specific sustainable finance risks, like greenwashing and product labelling.

2. IFRS ISSB Sustainability and Climate Reporting Standards update (financial institutions)

What: The ISSB announced on 17 February that its long anticipated sustainability and climate global reporting standards are to be released by the end of Q2 2023 and take effect in 2024. The announcement also noted that the European Sustainability Reporting Standards (ESRS) will be included in the appendix to the general sustainability reporting standard ("S1") as a source of guidance for companies, in the absence of specific ISSB standards. The first set of draft ESRS were released in November 2022 and will form a part of the EU's upcoming Corporate Sustainability Reporting Directive (CSRD) disclosure regime. Prior to the release of the new reporting standards, the ISSB will focus its efforts to build capacity to ensure the standards can be implemented globally. We will continue to watch this space closely for further developments.

3. Continued complexity within carbon credit markets - and a solution (multi-sector)

What: We have supported Climate Solutions in producing an introductory guide to carbon markets, in order to create one central resource to help readers understand the fascinating world of carbon markets. Carbon markets play a critical role in combatting the climate crisis as they support countries and companies to reduce their emissions by trading emissions/offsets in return for credits, as part of their wider carbon reduction and net zero strategies. In January, a Guardian article called into question the effectiveness and validity of carbon credits. The article revealed that more than 90% of rainforest carbon offsets issued by Verra, were likely to be "phantom credits", exaggerating the level of emission reductions actually achieved. Verra approves three out of every four voluntary offsets globally hence the article sparked great debate and confusion around carbon credits.

Admittedly this is a complex topic. For example, there are three carbon markets: mandatory/compliance carbon markets, voluntary carbon markets, and the sovereign carbon markets. As such, not all carbon credits are the same. This is why we decided to create a primer to help you better understand this nuanced subject. We believe that our introductory guide to carbon markets is an excellent starting to point to develop the knowledge required.

Looking ahead: Given the news surrounding Verra credits, there has been increasing demand to regulate voluntary carbon markets to improve the quality and credibility of the market. It is also likely that carbon credit buyers will look to diversify the types of carbon credits they purchase.

EU Developments

1. French Regulator proposes minimum sustainability criteria for SFDR funds (asset managers)

What: On 10 February the French regulator, *Autorité des marchés financiers* (AMF) published the position paper on proposed minimum sustainability criteria for Article 9 and Article 8 funds under the EU SFDR and an accompanying press release on 13 February. The AMF's action picks up on one of the topics that has long been discussed in the market, which is that the EU might bring in a set of minimum sustainability criteria to address the issue that the SFDR, even though it is a disclosure regime, is being used by investors as a labelling regime.

The paper proposes:

- Minimum environmental criteria should be established for the classification of products as Article 9 or Article 8. Compliance with these criteria would be subject to national supervision. The criteria for Article 9 should continue to be more stringent than those for Article 8.
- A minimum proportion of portfolio assets for Article 9 funds should consist of investments aligned with the Taxonomy. This percentage could increase over time as the European economy advances towards sustainability.
- Financial market participants that manage Article 8 and Article 9 funds should adopt a binding ESG approach in their investment decision-making process. The EU framework for minimum criteria should identify a set of acceptable ESG approaches that can be implemented by financial players.
- Article 9 funds should exclude investments in fossil fuel activities that are not aligned with the Taxonomy. Investment in such activities would be possible for Article 8 products provided that they meet strict conditions that ensure that these activities are engaged in an orderly transition.
- In a more exploratory approach, the AMF also proposes to introduce the concept of transition and engagement policies. It has identified possible avenues for a quantitative definition of assets in transition.

Looking Ahead: As a position paper, it has no legal or regulatory status, not even as a form of guidance, but it is indicative of some of the approaches that the EU could consider. It is worth noting that the AMF did state in their press release that they had discussed this with the Commission prior to publication – as we wait for the Commission to respond to some key interpretative questions on SFDR it will be interesting to see whether the AMF's position paper has any impact.

2. In other SFDR news (asset managers):

- The Level 2 SFDR RTS have been updated to take into account amendments regarding fossil gas and nuclear activities, with effect from 20 February. The amendments to the SFDR Level 2 RTS brought about as a result of the Complementary Delegated Act (CDA) under the EU Taxonomy, which covers fossil gas and nuclear activities, have now been published in the Official Journal - they come into effect on the third day following publication. Learn more here.
- The *Commission de Surveillance du Secteur Financier* (CSSF), the financial regulator in Luxembourg announced on 1 February the intention to launch a data collection exercise for investment fund managers (IFMs) related to SFDR. IFMs captured are required to complete a questionnaire on their organisational arrangements via a "SFDR-IFM disclosures" digital module and the deadline for submission is 2 March. There will be future calls for further information to collect data from Principal Adverse Impact (PAI) statements and data within precontractual and periodic disclosure templates. Be sure to keep an eye on developments as further details on the timing and practical procedures for data collection will be announced at a later date.

3. European Commission renewable hydrogen rules (multi-sector)

What: This month the European Commission adopted two Delegated Acts required under the Renewable Energy Directive, defining what it considers as renewable hydrogen and what can be counted towards a Member State's renewable energy targets. Hydrogen production requires significant energy consumption. Therefore there were questions surrounding how to prevent hydrogen from putting a strain on scarce renewable energy resources and on energy prices.

One of the Delegated Acts defines under what conditions hydrogen can be classified as "Renewable Fuels of Non-biological Origins" (RFNBOs) and clarifies that where production is not from a dedicated renewable sources, then the principle of additionality comes into play. Hydrogen production must be matched by additional renewable energy production on an hourly basis by 2030 and until then on a monthly basis, which incentivises an increase in renewable energy available on the grid. The phased in approach gives time for the hydrogen market in the EU to grow. The additionality rule contains an exemption for countries with a low-carbon electricity mix that can show that production power came from renewable sources.

UK Developments

1. FCA's Discussion Paper on firms' sustainability-related governance (financial institutions)

What: On 10 February, the FCA published Discussion Paper (DP23/1), which opens an industry-wide dialogue on financial services firms' sustainability-related governance, incentives, and competence arrangements. As the feedback to the DP will influence the FCA's regulatory approach and supervisory engagement with firms, it will be of interest to regulated firms across the financial services sector.

The DP seeks industry feedback on a number of issues, most notably for firms (and their senior management):

- whether there is a need to introduce additional regulation to extend individual responsibility for sustainability-related matters to senior management and whether to set specific expectations around the roles and responsibilities of governing bodies, such as fund boards;
- appropriate metrics and weights for linking remuneration to sustainability goals and what adjustments should be made when targets are not met;
- additional regulatory measures that could be introduced to encourage effective stewardship of assets and to direct stewardship efforts towards the most pressing systemic issues; and
- introducing additional training and competence expectations within existing rules or guidance.

Read our summary of the DP here.

Our view: The DP emphasises that it is important for financial services firms to keep pace with the increased regulatory focus on sustainability. Therefore, firms should consider reviewing their

sustainability-related governance, incentives, and competence arrangements to ensure that they continue to be fit for purpose and take into account evolving best practices and regulatory expectations. Given the DP's wide application, we also strongly encourage impacted firms to consider responding to the DP either directly or through industry groups.

Timing: The deadline for responses to the DP is 10 May 2023.

2. Shell's board of directors sued over its net zero transition (multi-sector)

What: ClientEarth has now filed its claim against the directors of Shell alleging that Shell's current strategy to meet the targets set in the Paris Agreement and its transition to net zero is in breach of the directors' duties under the Companies Act 2006. ClientEarth brings the claim as a shareholder of Shell and with the support of a large group of other shareholders including large pension funds and other institutional investors. ClientEarth wants to compel the 11-director board "*to act in the best long-term interests of the company by strengthening its climate plans*".

ClientEarth announced its intention to launch the claim in March 2022 (see our update here for more details), following the ruling by the Hague District Court ordering Shell's then Dutch parent company to amend its corporate policy to reduce its emissions. This case breaks new ground in that it is the first of its kind in the world to hold corporate directors directly liable for failing to properly prepare their company for the net zero transition.

Looking ahead: Whilst ClientEarth's claim against Shell's directors is relatively novel, we can see similar claims being brought in the future as the number of climate-related cases continues to grow at pace. Campaigners and even shareholders are likely to target the private sector from a variety of angles including challenges to how well their commitments chime with national and international climate targets, greenwashing, and breaches of corporate law.

3. ClientEarth launches claim against the UK FCA (FCA) over its approval of environmental disclosures (multi-sector)

What: ClientEarth strikes yet again – this time filing a judicial review case against the FCA, seeking a declaration from the High Court that the FCA's approval of a prospectus by oil and gas operator and producer, Ithaca Energy PLC, was unlawful and in breach of the Prospectus Regulation. The action alleges that Ithaca's prospectus fails to adequately describe the climate risks associated with the company's activities, which includes part ownership of the Cambo and Rosebank oil and gas fields in the North Sea.

ClientEarth alleges the following three deficiencies with Ithaca's prospectus, which it argues are vital to allow investors to make an informed assessment of the company's financial position:

4. The risks disclosed in Ithaca's prospectus are too general in nature to leave investors fully informed or to meet the Prospectus Regulation requirements;
5. The prospectus does not address the apparent conflict between Ithaca's intention to develop new fossil fuel assets and the International Energy Agency's conclusion that no new fuel fossil fuel infrastructure can be built if the world is to meet a 1.5 °C warming target; and
6. The prospectus fails to explain how the company's business model and financial prospectus would need to change, or be affected, if the Paris Agreement goals are to be achieved and what impact that would have on their key assets.

Looking ahead: The very fact that ClientEarth has attempted to bring an action will focus the minds of companies, their advisers and the regulator to the nature of ESG disclosure in prospectuses and other public disclosure. Further, if ClientEarth is successful, this may embolden other stakeholders to pursue litigation in connection with ESG disclosures by listed companies. We will update you as this claim progresses, including whether the High Court grants permission for ClientEarth to bring the claim.

4. High Court rejects judicial review challenge against UK Government for failing to halt imports of cotton allegedly produced with forced labour in China (multi-sector)

What: The High Court has rejected an action brought by Global Legal Action Network (GLAN) and the World Uyghur Congress (WUC) against UK Government enforcement authorities for failures to investigate breaches of the Foreign Prison Made Goods Act 1897 (FPMGA) and the Proceeds of Crime Act 2002 (POCA) arising in connection with the import of Uyghur forced and prison labour cotton from Xinjiang, China.

GLAN and WUC relied on the evidence of widespread prison labour in Xinjiang to assert that at least *some* of the cotton imported into the UK had been manufactured in a foreign prison, contrary to FPMGA. Under POCA, GLAN and WUC asserted that the imported cotton represented a benefit from criminal conduct, with its acquisition, use or possession by any UK person being a money laundering offence.

The Court rejected these arguments since there was no evidence that linked a specific consignment of cotton to either prison or forced labour. In relation to the POCA argument, the Court also held that, given the availability of an adequate consideration defence, a successful prosecution required evidence that the consignment had been purchased at a significant undervalue. A particular challenge in the context of a lengthy international value chain, since the chain could be broken by any payment for market value in any of the transactions involved.

However, although the Court rejected these claims, it emphasised the judgment did not undermine the "*striking consensus in the evidence that there are clear and widespread abuses in the cotton industry in [Xinjiang]*", and that other legal tools or further evidence may come to light which could meet the required thresholds.

Looking ahead: This confirmation of the high evidential threshold for investigating and prosecuting criminal offences linked to prison and forced labour will provide some reassurance to businesses with cross-border supply chains in the garment industry and other higher risk sectors, and those who finance them. However, in light of increasing focus from multiple stakeholders on modern slavery risks, businesses will need to pay continued close attention to their financial crime risks and obligations.

Middle East Developments

1. Saudi Exchange announces trilateral MoU to help implement ESG framework in Saudi Arabia

What: At the Saudi Capital Market Forum held in Riyadh on 11 February, the CEO of the Exchange, Mohammed Al-Rumaih, announced that the Saudi Tadawul Group (which operates the Saudi stock market) has signed a trilateral memorandum of understanding with the Saudi Capital Market Authority and the Ministry of Planning and Economy to assist the three partners in implementing an ESG framework in the Saudi Capital Market. Al-Rumaih noted that "*ESG is very strategic to us. This is one of the areas that have witnessed the best growth*" adding that the Saudi Exchange expects 30% of its listed companies to make ESG disclosures this year.

2. New Dubai Virtual Assets Regulatory Authority (VARA) Regulations

What: On 7 February, new licensing regulations were introduced by VARA, the regulator of virtual asset activities in the Emirate of Dubai (excluding the financial free zone of the Dubai International Financial Centre). Notably, the Regulations contain disclosure requirements related to ESG issues, which makes VARA the first regulator in the UAE to impose ESG disclosure requirements specifically on virtual asset service providers.

Under the Regulations, when a virtual asset service provider (VASP) applies for a licence, VARA would determine which of three ESG disclosure levels applies to them, taking into account factors such as the size and business model of the VASP and its group. These three ESG disclosure levels are: 'Voluntary ESG Disclosure', 'Compliance ESG Disclosure' and 'Mandatory ESG Disclosure'. The Mandatory ESG Disclosure is the most onerous and would require a VASP to establish practices and procedures to raise awareness of ESG-related activities and opportunities; publish an annual ESG report disclosing and publicise information on its D&I initiatives prominently on its website.

Other notable ESG-related requirements in the Regulations include the need to publicly state the use of renewable energy and initiatives relating to decarbonisation and emission reduction when conducting mining or staking activities, regardless of a VASP's ESG disclosure level; and the need to consider ESG issues when selecting service providers (e.g., VASPs should be satisfied that the service provider acts in an ethical and socially responsible manner). Such regulations are encouraging in terms of fostering a more ESG-friendly landscape in the UAE and for virtual asset service providers.

3. UAE Securities and Commodities Authority introduces new categories of specialised funds, including ESG funds

The Securities and Commodities Authority (the SCA) of the United Arab Emirates has recently made numerous changes to the funds regime applicable in 'onshore' UAE (i.e. excluding the Abu Dhabi Global Markets and Dubai International Financial Centre financial free zones). Amongst the recent changes, on 16 January, the SCA introduced a series of new specialist funds, such as ESG funds whose investment

portfolio and/or fund strategy shall comply with ESG criteria to be set out in the fund's prospectus. With its new regulations, the SCA aims to boost the number of local funds.

Asia Developments

1. Monetary Authority of Singapore Disclosure Guidelines for Retail ESG Funds

What: On 3 January, the Monetary Authority of Singapore (MAS) issued FAQs on the circular CFC 02/2022 Disclosure and Reporting Guidelines for Retail ESG Funds that was issued on 28 July 2022. The Circular sets out the MAS' expectations on how existing requirements under the Code on Collective Investment Schemes and the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations apply to retail ESG funds and the FAQs further clarify these expectations. You can read more about this in our summary of these FAQs here.

2. ISDA Publication: Regulatory Framework for Sustainability-Linked Derivatives (Singapore)

In early February, ISDA published their paper on the Regulatory Framework for Sustainability-Linked Derivatives in Singapore. The paper is the equivalent for Singapore of ISDA's December 2021 whitepaper, on Regulatory Considerations for Sustainability-linked Derivatives (SLDs), which explored regulatory issues for SLDs in the UK, EU and US. This paper considers whether SLDs in Singapore would be classified as over-the-counter derivatives transactions or another type of regulated product, how they are regulated and compliance issues for market participants to consider when executing SLDs.

ESG Consultation round-up

Some notable ESG policy consultations in flight across the globe that are currently open for comment. Such engagement is a great opportunity to influence the direction of travel for ESG matters.

1. ASCOR Consultation to assess sovereign debt issuers on climate change (financial institutions)

What: On 7 February, Assessing Sovereign Climate-Related Opportunities and Risks (ASCOR) launched a consultation report on the first public investor framework to assess sovereign bond issuers on climate change. The framework sets out a common basis to assess individual country climate change approaches and will reinforce public disclosures to aid investors to understand sovereign action and progress. The consultation aims to engage with sovereign bond issuers, development finance institutions, investors, civil society and the wider public. It welcomes feedback on the principles underpinning the framework, on the proposed indicators, and methodology, as outlined in the report.

Timing: ASCOR will be running public webinar and regional roundtables in February and March 2023 to engage with stakeholders. The consultation closes on 31 March 2023.

2. European Commission Consultation on product categories under proposed Ecodesign for Sustainable Products Regulation (multi-sector)

What: On 1 February, the European Commission published a public consultation seeking views on the categories of new products and measures that the proposed Ecodesign for Sustainable Products Regulation (ESPR) should prioritise. It focuses on products and measures that are not currently within the scope of the Ecodesign Directive (2009/125/EC) (which only covers energy-related products).

The draft ESPR aims to make products sold in the EU, including end-use products like textiles, furniture, toys, as well as intermediary products like iron, steel and plastics, subject to performance and information-related requirements, to ensure greater sustainability. It includes a framework for setting ecodesign requirements based on multiple criteria including durability, circularity, use of substances of concern, energy efficiency and carbon footprint. The ecodesign requirements will be set on a product-by-product basis, or on the basis of groups of products with enough similar characteristics.

Timing: The consultation closes on 25 April 2023 and the Commission is aiming to adopt a communication in Q1 of 2024.

3. UK HMT consultation and call for evidence on the regulation of cryptoassets

What: On 1 February, the HM Treasury published a consultation setting out its proposal for the future regulatory regime for cryptoassets, including a chapter on sustainability and cryptoassets. The objective of the proposal is to establish a proportionate and clear regulatory framework which enables firms to innovate at pace, while maintaining financial stability and clear regulatory standards. The call for evidence specifically relating to sustainability, asks:

- What information regarding environmental impact and / or energy intensity would investors in cryptoassets find most useful for their decisions?

- What reliable indicators are useful and / or available to estimate the environmental impact of cryptoassets or the consensus mechanism which they rely on? And what methodologies could be used to calculate these indicators?
- How interoperable would such indicators be with other recognised sustainability disclosure standards?
- At what point in the investor journey and in what form, would environmental impact and / or energy intensity disclosures be most useful for investors?
- Will the proposals for a financial services regulatory regime for cryptoassets have a differential impact on those groups with a protected characteristic under the Equality Act 2010?

Timing: The consultation closes on 30 April 2023.

Recent publications:

- ESG – SFDR RTS changes on fossil gas and nuclear activities published (17 February 2023)
- ESG: FCA opens discussion on governance, incentives and competence (13 February 2023)
- Carbon Markets: An introductory guide (9 February 2023)
- ESG: UK SDR – Simmons responds to the FCA's consultation paper (25 January 2023)
- European energy regulation overview (24 January 2023)
- Oversight: FAQs on disclosure and reporting guidelines for ESG funds (10 January 2023)

Euronext may have to dig deeper to snare Allfunds; The 8 bln euro exchange offered 5.5 bln euros for the wealth technology group, the latest in a slew of deals. Boss Stéphane Boujnah would get much-needed diversification away from sluggish markets. Yet the price is not a knockout, and rivals like Deutsche Boerse could barge in.

- Logic would tell you that a simple change in the calendar year has no impact on the state of the global economy. But markets aren't exactly known for being logical. Since January 1, the doom and gloom of 2022 has been replaced with hopes of a soft landing in 2023—or at least the feeling that the bond market has to be better this year than last.
- This relative calm has kept trading volumes consistent over the past six months, with ADV up 5% month over month and down 12% from January of 2022. January U.S. Treasury futures volumes tracked the cash market, dropping 11% from the year before.

As we head into February, regulators are again pressing ahead with their ESG agendas. Following a flurry of regulatory publications in the run-up to the holiday season, indications so far in 2023 are that regulators are well and truly in 'back to work' mode. However, this edition is shorter than the last one as we move to a bi-monthly publication cycle to bring you updates more rapidly.

- One of the most significant updates at the end of 2022 was the UK government's announcement on the proposed Green Taxonomy. This finally confirmed publicly that the Taxonomy has been delayed, and that the expected approach will be considered "carefully" – paving the way for changes to both the substance and form. The independent "Skidmore Review", published in early 2023, maintains pressure on the UK government to fulfil its net-zero ambitions and includes recommendations that will be of interest to businesses across the UK, including financial services firms.
- Looking to the EU, the changes that were made in July 2022 to include certain nuclear/gas activities in the EU Taxonomy entered into force on 1 January 2023. Consequential amendments will be made to the Sustainable Finance Disclosure Regulation (SFDR) product-level disclosure templates. The ESMA (ESMA) also published advice from its Securities and Markets Shareholder Group (SMSG) on how exposures to fossil gas and nuclear energy should be disclosed in precontractual information and periodic reporting. The European Commission has adopted revisions to the templates, but they are still being considered by the Council and Parliament.

- Still on disclosures, asset managers should take note of ESMA's research paper on the proposed EU Ecolabel for retail financial products – while there is no action to take, the paper highlights the challenges in developing a stringent yet feasible labelling framework. Additionally, the three European Supervisory Authorities (ESAs) each published their opinions on the draft European Sustainability Reporting Standards (ESRS), which are due to be adopted in June 2023. At a global level, the ISSB is still deliberating on the detail of its first two standards for sustainability and climate-related disclosures and has announced that they too will be finalised in June this year.
- The UN's COP15 conference in Montreal at the end of 2022 was a significant moment. The Kunming-Montreal Global Biodiversity Framework (GBF) was introduced, with governments signing up to ambitious commitments to preserve and protect biodiversity. For financial services firms, the expectations on reporting and disclosures are particularly relevant.
- Climate-related financial risk continues to be a priority for banks and insurers. EIOPA has published two papers: a discussion paper on the prudential treatment of sustainability risks, and another on the transition risk exposure of Institutions for Occupational Retirement Provisions (IORPs). The Basel Committee on Banking Supervision (BCBS) has released FAQs on how climate-related risk should be captured in Pillar 1 calculations, and the European Central Bank (ECB) has published climate-related statistical indicators to help narrow the climate data gap. In the UK, the Climate Financial Risk Forum (CFRF) released cross-sectoral guides following its third session. For the first time the guides cover the transition to net zero, as well as continuing to focus on scenario analysis, disclosures, data and metrics.
- Regulatory attention has turned to the role of carbon markets. The European Council and Parliament reached provisional agreement on the Carbon Border Adjustment Mechanism (CBAM), and the European Commission, under the European Green Deal, has proposed a voluntary framework to certify high-quality carbon removals. Additionally, the International Organisation of Securities Commission (IOSCO) has launched two public consultations on the development of Compliance Carbon Markets (CCM) and Voluntary Carbon Markets (VCM).
- Looking ahead, the PRA's annual letters to banks and insurers have noted climate risk as an ongoing supervisory priority, and the International Association of Insurance Supervisors' (IAIS) 2023 – 2024 Roadmap reinforces its commitment to responding to the emerging and accelerating risks, as well as challenges and opportunities, of climate change.

Enhancing the effectiveness of carbon markets; IOSCO targets enhancements; *In the drive to support a rapid and orderly transition to net zero, carbon emissions have become a critical piece of information for internal and external stakeholders. To ensure that firms are supporting decarbonisation initiatives, governments and regulators have begun putting into place the regulatory and market infrastructure that is needed to realise net zero.*

- The first priority for any firm looking to decarbonise its operations is to reduce, to the maximum extent possible, its direct or indirect carbon emissions. In practice, this may mean switching to fossil-free fuel sources, investing in cleaner manufacturing processes and ensuring the sustainability of raw materials. However, many firms will have some level of residual greenhouse gas (GHG) emissions which cannot be decarbonised. These residual emissions can be offset through the use of carbon credits in either voluntary or compliance markets.
- Compliance markets are government mandated schemes which set limits on the amount of GHGs which can be emitted by individual firms, sectors of the economy or by the economy as a whole. In the EU, the Emissions Trading System (ETS) covers industries such as air travel and will gradually reduce the legally permitted amount of carbon which can be emitted. Similar systems exist around the world, including in the UK.
- Other firms participate voluntarily in GHG emissions trading. To offset the impact of non-decarbonised aspects of their business processes, they purchase financial instruments which represent an amount of GHG which has been removed from the atmosphere or prevented from being emitted. These instruments are increasingly sophisticated and include derivative

instruments as well as more standardised contracts. For more on the operation of carbon markets, see our previous article.

- It has become clear that the rapid and unequal development of compliance and voluntary carbon markets is having an impact on their effective functioning. In response, in November 2022, the International Organization of Securities Commission (IOSCO) launched two public consultations on recommendations for national supervisors and industry organisations to enhance the effectiveness of carbon markets.
- Recommendations for compliance markets; In its consultation on Compliance Carbon Markets, IOSCO anticipates that more jurisdictions will begin building compliance market infrastructure in the future, and makes recommendations for their initial construction as well as effective long-term functioning. As a first step, IOSCO recommends that markets should be sufficiently ambitious in scope. A market which offers too many carbon credits or offers them at a low price may not achieve its aim of reducing emissions. As markets mature, it will become more important to maintain confidence in the predictability of market patterns by providing trading information transparently to other participants and ensuring rules are in place to govern any stability mechanisms.
- IOSCO observes that, ultimately, the distinction between compliance markets and voluntary markets may be blurred — and recommends exploring ways to open compliance markets to include a much broader section of the economy, including allowing non-mandated firms to opt in and compete for carbon credits. By increasing the competitiveness of the market, IOSCO suggests that the most carbon-intensive firms would be incentivised to decarbonise at a faster rate than is currently likely.
- Recommendations for voluntary markets; However, it is unlikely that voluntary markets will be integrated into compliance markets in the short term. IOSCO's second consultation on Voluntary Carbon Markets notes that further development is required to increase their effectiveness. IOSCO proposes that voluntary markets should be open to broad involvement, but key participants and infrastructures should have effective risk management and governance frameworks. IOSCO also recommends that rules-based market oversight should be established to prevent fraud, manipulation and abusive practices.
- More broadly, IOSCO notes that a carbon market cannot function in isolation and that it will be important to develop holistic, cross-market mechanisms which standardise the global carbon price. This will ensure that carbon-intensive activities are not outsourced to jurisdictions where the carbon price is much lower even though the impact on the climate is the same — a phenomenon known as `carbon leaking'. Voluntary and compliance markets will need to work together to set consistent pricing. IOSCO suggests that regulators may wish to lead in developing cross-border memorandums of understanding, or building the infrastructure for a global, central securing registry system which would facilitate the convergence of global carbon pricing.
- Other initiatives; *The EU has committed to developing a voluntary framework to certify high-quality carbon credits, demonstrating how regulators can provide the tools and impetus to voluntary carbon markets to improve transparency, access and confidence in their functioning.*
- The high-level details released so far indicate that the framework will focus on the removal of carbon from the environment, providing a net climate benefit, rather than rewarding the reduction of carbon emissions. The framework will allow independent assurance of the quality of carbon credits, and the framework's criteria for assurance will align to the EU's other sustainability objectives — including requirements relating to a circular economy, land and marine pollution, and preserving and building back biodiversity.
- The EU has also forged ahead in developing its own solution to carbon leaking — the Carbon Border Adjustment Mechanism (CBAM). While the exact details of implementation are still being worked out, the recently agreed levy is ambitious in its scope and goal of reducing global carbon emissions, not just those emitted in the EU.
- Under current plans, the levy will apply from October 2026 to all imports of some of the most carbon-intensive goods, such as metals and cement, although the scope is likely to expand to

capture plastics and potentially even finished goods such as vehicles in the medium term. Imports will be taxed based on the difference between the EU's carbon price and any price that has been incurred outside the EU. With the EU's carbon price currently hovering around €90 per tonne and only expected to rise, this levy will not only have a monetary impact on corporates but will have an impact on the credit and market risk profile of investment and lending portfolios, potentially altering the transition risks to which financial services firms are exposed.

- Supporting its ambition of becoming a net-zero economy by 2050, the UK Government is also exploring options for its own CBAM. Although details and potential timelines are currently unclear, a UK CBAM would undoubtedly assist firms in their transition to net zero by removing their competitors' ability to offshore carbon emissions to maximise UK profitability. As firms prepare to make their first transition plan disclosures, their decarbonisation strategy is likely to become an important driver in stakeholder value, as well as impacting their risk profile for banks and other financial investors.
- Looking ahead; IOSCO's consultation papers set the direction of travel for 2023 — more governments will establish or develop their compliance markets and the voluntary carbon markets will continue to evolve. At the same time, regulatory initiatives to support the effective functioning of these markets are gaining momentum. Careful and efficient regulation will ensure that the carbon markets support an economy-wide transition to net zero.

The DTCC has issued a first-ever analysis on how climate-related financial risk may impact market infrastructures, in a new whitepaper that highlights the unique nature of FMIs' exposure to climate-related risk and emphasizes value of existing regulatory framework.

ESMA issues its first opinion on the draft European Sustainability Reporting Standards : ESMA finds that ESRS Set 1 broadly meets the objective of being conducive to investor protection and of not undermining financial stability.

ALFI provides a targeted response to the ESAs Call for evidence on better understanding greenwashing : ALFI focused on proposing a definition of greenwashing whose main characteristic should be intent. Based on the definition, complementary examples on what should not be considered as greenwashing were provided.

EURACTIV: EU due diligence rules should include finance, Commissioner says : Commissioner for Justice Didier Reynders said the EU executive's goal is to include the financial sector under the EU rules on corporate accountability after it was carved out from mandatory due diligence by member states in their common negotiating position.

Statement by President von der Leyen on the Green Deal Industrial Plan : We know that in the next years the shape of the net-zero economy and where it is located will be decided, and we want to be an important part of this net-zero industry that we need globally.

UN EP FI: Net-Zero Asset Owner Alliance raises expectations for members' real economy impact with updated Protocol : Updated methodology now covers private assets target-setting including Commercial Real Estate Lending, and reporting on Sovereign Bonds,

OIES Key Themes for the Global Energy Economy: 2023 A year for the EU to deliver the legislative framework of the Green Deal

- Since the Commission tabled 'Fit for 55' packages in July/December 2021, the European Council and European parliament (EP) have worked diligently to advance these initiatives.
- Besides the acts already agreed in November and December 2022 all legislative acts of the two Fit for 55 packages complemented by a new proposal regarding electricity markets design and a Hydrogen Bank, need to be adopted by European legislators before the end of 2023.

- Timing is not only crucial in order to speed up implementation of Fit for 55 packages but is indispensable because EP will not be able to exercise its role as co-legislator after Q1 2024 due to European elections in June 2024 and start of the election campaign in April 2024
- Work program for 2023 represents a huge challenge for the European institutions but the EU must deliver on all its ambitious legislative actions if it wants to live up to its climate targets
- This needs to happen at a time where the energy crisis is causing economic and social challenges in the shadow of the ongoing Russian
- If in previous times when EU had to go through economic or political crises there was always the expectation that it would emerge even stronger from the crisis, this expectation cannot be taken for granted this time.
- Negotiations will show whether or not the Member States in Council, the different political groupings in the EP, and the Commission are capable of striking compromises that truly deliver on all three overarching energy policy objectives: fostering sustainability; safeguarding energy security; and guaranteeing households and industries affordable energy prices by developing necessary support instruments at EU and national levels including targeted measures to help the most vulnerable and energy poor

January 2023

Since the Commission tabled the 'Fit for 55' packages in July/December 2021, the European Council (the Council) and the European Parliament (EP) have worked diligently to advance these initiatives. Besides the acts already agreed in November and December 2022, all the legislative acts of the two Fit for 55 packages, complemented by a new proposal regarding electricity market design and a Hydrogen Bank, need to be adopted by European legislators before the end of 2023. This timing is not only crucial in order to speed up the implementation of the Fit for 55 packages but is indispensable because the EP will not be able to exercise its role as co-legislator after Q1 2024 due to the European elections in June 2024 and the start of the election campaign in April 2024.

The following sections provide an overview of the legislative process that needs to happen in 2023 and highlights the major issues which are at stake in each area:

Legislation adopted relating to the two Fit for 55 Packages and due to come into force in 2023

The Council and the EP reached a provisional political agreement on the reform of the ETS[1] and the CBAM[2] in November/December 2022 pending formal adoption by both institutions which is due in early 2023.

The Council also formally adopted new measures on Joint Purchases of Gas and a Solidarity Mechanism in December 2022. In addition, in December 2022 the Council adopted a regulation that establishes a Market Correction Mechanism to protect citizens and the economy against excessively high prices. The regulation aims to limit episodes of excessive gas prices in the EU that do not reflect world market prices, while ensuring security of energy supply and the stability of financial markets. All three measures are due to come into force in 2023.

Ongoing legislative debate relating to the two Fit for 55 Packages

- Renewable Energy Directive: Discussions are continuing, with the key areas of debate being the headline renewables target, the obligation to replace 75 per cent of grey hydrogen in

Congress eyes probe of ESG role at US banks, funds US House financial services subcommittee chair Rep. Andy Barr, Ky.-R, plans to grill banks and asset managers for more information about their environmental, social, and governance goals and investment practices. Barr says that banks should be non-political, and that in order for the US "to be economically competitive we need our financial system to provide equal access to capital to all kinds of businesses." Financial Times

Dec 23 EUA 95.40

One-sided upward momentum in EUAs appeared to be a combination of massive, short covering, according to weekly COT report and forward hedging due to colder weather forecast.

- Buy side support could also be observed in power and gas markets, which have been driven by the same fundamentals as EUAs. Carbon has rallied in a straight line from 83 to 97.55 EUR in the past 6 trading sessions, offering no substantial pullbacks.
- Market did however find short term technical resistance in the mid of the way up, at around 90 EUR from where prices stalled for a short period. Corrections to the downside have been short-lived and dips were reverted with ease, as offer side often turned out to be empty. Along with aggressive futures buying in EUAs that we have seen in the past week, auctions confirmed bullish narrative, since they usually cleared from 20 to 35 cents above prevailing spot prices.

- When market finally crossed above 90EUR it caused a sharp move a couple of euros higher, where December-23 futures contract finally settled at 93.01 EUR per tonne. For the reference, last time the same contract settled above 90 EUR was more than a month ago and only for one day. Interestingly, one the possible catalysts could be unusually strong UKA auction which cleared almost 1 GBP above secondary market. Such large premium might have caused panic in short-positioned participants, not only in UKAs but in EUAs. Once market started to move aggressively, options implied volatility has risen as well, adding to the upwards pressure.
- German power prices are up by 19.50 EUR since last week, with the front year contract trading at 185.00 EUR/MWh. API2 coal prices are up by 8.00 USD since last week, with the Cal24 contract trading at 153.00 USD/tonne. EUR/USD is up by 50 points since last week and is currently trading 1.0920.

ICE has published its Sustainable Finance Monthly, a summary of recent ICE research delivered under the signature of Elizabeth King, president, sustainable finance and chief regulatory officer for ICE. The newsletter reports on subjects including trends in funds integrating sustainability factors into their investment purposes; the link between ICE Social Impact scores and school district outcomes; and the importance of materiality in emissions reporting. You can read the newsletter and access the research here.

AFME's European Sustainable Finance Conference, 11-12 May 2022, Amsterdam Our comprehensive two-day programme addresses the latest developments and key issues facing banks and investors, including the latest on European and international sustainability disclosure standards, taxonomies, ESG bond markets, risk management and climate stress testing, amongst others. To view the full agenda, please click here.

Response to FCA's Consultation on Sustainability Disclosure Requirements and Investment Labels

ISDA Joins Associations in Call for Risk-based Approach to CSDDD

ISDA Responds to ESAs Call for Evidence on Greenwashing

Michael Bloomberg has an editorial titled "The World Bank Must Take Bolder Action on Climate."

Refinitiv: Value of global carbon markets hits $909B Carbon markets around the world were valued at a record $909 billion in 2022, according to Refinitiv. The largest is the EU's Emissions Trading System, but two regional markets in North America -- the Western Climate Initiative and the Regional Greenhouse Gas Initiative -- are also growing. Reuters

ISDA Asia-Pacific Regulatory Framework for Sustainability-linked Derivatives: Singapore Analysis; Environmental Social and Governance (ESG), Singapore, Sustainability-linked Derivatives, Sustainable Finance; February 7, 2023

- Singapore is taking a number of steps to achieve its ambition of net-zero carbon emissions by approximately 2050, including the progressive raising of carbon taxes from 2024 and the launch of the Singapore Green Plan 2030, which sets sustainability targets to be achieved over the next 10 years.
- The Monetary Authority of Singapore has complemented these initiatives by setting out a strategy to strengthen the resilience of the financial sector to environmental risks, and to position Singapore as a leading center for sustainable finance.
- A number of financial products linked to environmental, social and governance (ESG) factors have emerged globally to help firms achieve their sustainability objectives and hedge climate risk. This includes sustainability-linked derivatives (SLDs), which embed a sustainability-linked cashflow in a derivatives structure and use key performance indicators (KPIs) to monitor compliance with ESG targets. However, it is necessary for users to understand how these instruments fit into existing regulatory regimes.
- This paper focuses on the regulation of over the counter (OTC) derivatives in Singapore. The intention is to describe potential regulatory approaches to OTC SLDs and provide guidance to help market participants develop their own assessments.
- Two categories of SLDs are covered in this paper:
    - Category 1 SLDs: The KPIs and related cashflows are embedded within the derivatives transaction. An example of a Category 1 SLD is a cross-currency interest rate swap that provides additional payments, spread ratchets or a preferential exchange rate when a KPI is met.
    - Category 2 SLDs: The KPIs and related cashflows are set out in a separate agreement that references underlying (generally vanilla) derivatives transactions for setting the reference amount to calculate the KPI-linked cashflow. The terms (including pricing) of the underlying transactions (which may include transactions with other affiliates of the parties) would generally not be affected. An example of a Category 2 SLD is an agreement to make a payment if a counterparty meets its KPIs, calculated as a percentage of the notional amount of unrelated, separately documented derivatives transactions.

BNP Paribas rises in ranks of top ESG fund providers BNP Paribas Asset Management has become the EU's second-largest provider of Article 9 environmental, social and governance funds. BNP's rise has come as rival fund managers' Article 9 products, which are supposed to meet the most stringent criteria for sustainability, have recently faced a wave of downgrades. Bloomberg

House Financial Services Committee Republicans Establish ESG Working Group; New House Financial Services Committee Chair Patrick McHenry (R-NC) established a Republican ESG Working Group to "combat the threat to our capital markets posed by those on the far-left pushing [ESG] proposals."

ETF Seizes on ChatGPT Buzz with a Focus on 'Conversational' AI; ETF aims to capture ChatGPT craze but may struggle: Balchunas; Fund aims to invest in companies focused on conversational AI Wall Street's $6 trillion ETF machine rarely lets a viral trend pass it by. OpenAI's chatbot is no exception. Enter the Conversational AI, AI, and Innovation ETF, which would trade under the ticker CHAT. The actively-managed fund will seek to invest in global stocks that are primarily connected with artificial intelligence, with an emphasis on "conversational" AI and innovation, according to a SEC filing Thursday. /jlne.ws/3DGGXEs

BNP Reaps Reward of $20 Billion ESG Fund Call with New Dominance; As the dust settles on the wave of ESG fund downgrades that swept through Europe's investment industry, BNP Paribas SA has managed to climb several notches up a controversial ladder. BNP Paribas Asset Management is now the second-

biggest provider of the European Union's top environmental, social and governance fund class, known as Article 9. /jlne.ws/3X8olV0

European Parliament to vote on early CO2 permit auctions; The European Parliament is set to vote on allowing carbon permits to be auctioned early to raise €20 billion for countries seeking to replace Russian natural gas. Carbon prices hit near record highs last week when some market participants anticipated the EU lawmakers would delay a vote until April. Reuters

Carbon-Credit Raters Aim to Assess a Notoriously Opaque Market; Rating firms flagged problematic anti-deforestation projects before a flurry of media coverage alleging these projects fell short of goals; A new breed of credit raters wants to help companies make better sense of carbon offsets, which many businesses have shunned because of concerns about the reputational risk of "greenwashing" that can come from projects with uneven standards and inaccurate measurements. Carbon-credit-rating firms aim to give buyers confidence in assessing the unregulated market for carbon offsets, voluntary credits that can help companies fulfill their decarbonization promises. Traders, online marketplaces, and corporate sustainability departments are typical customers for carbon-credit ratings, but companies increasingly encounter the scores through intermediaries selling the offsets. Each credit theoretically represents one metric ton of carbon dioxide avoided or removed from the atmosphere. /jlne.ws/3RExhQF\

Global banks back carbon credit trading platform A consortium of global banks has invested $45 million in carbon credit trading platform Carbonplace. The platform will enable the banks to offer carbon-credit buying and selling services to their corporate clients. Reuters

- Currently the credits are often traded bilaterally on a project-by-project basis and through commodity exchanges.
- Each of the banks - BBVA, BNP Paribas, CIBC, Itaú Unibanco, National Australia Bank, NatWest, Standard Chartered, SMBC and UBS – have invested $5 million in Carbonplace, which will connect buyers and sellers of credits through the banks. "The capital injection represents a commitment from some of the world's largest financial institutions, which account for nearly $9 trillion in total assets, to achieve Carbonplace's vision of accelerating corporate climate action by providing transparent, secure and accessible carbon markets," Carbonplace said in a statement.
- The credit platform will be available to the banks' corporate clients later this year, and in future could also be open to retail customers, Robin Green, Carbonplace Chief Technology Officer told Reuters. He said the funding will be used to grow the team and scale up the platform's infrastructure. Green said the offset credits available would be those issued by existing carbon offset standards groups such as Gold Standard and Verra.

2023 FCA publish Discussion Paper on finance for positive sustainable change: governance, incentives, and competence in regulated firms; On *10 February 2023, the FCA published Discussion Paper 23/1 'Finance for positive sustainable change: governance, incentives and competence in regulated firms' (DP23/1). DP23/1 will be of interest to all regulated firms across the financial services sector. The aim of DP23/1 is to encourage an industry-wide dialogue on firms' sustainability-related governance, incentives, and competences. In the first part of DP23/1 the FCA:*

- Examines how governance, incentives and competence are considered in the Taskforce on Climate-related Financial Disclosures' recommendations, and how expectations in these areas are evolving with the work of the International Sustainability Standards Board, the UK's Transition Plan Taskforce and the Glasgow Financial Alliance for Net Zero.
- Considers more deeply firms' sustainability-related objectives and strategies, and how these are supported by their governance and incentive arrangements. In addition, the FCA reflects on how asset managers and asset owners organise and govern their stewardship activities to influence positive change.

- Considers firms' training and competence.
- In the second part of DP23/1 the FCA includes commissioned articles. These articles, together with the FCA's analysis, may help firms reflect on how their approaches to governance, incentives and competence support positive change. This may encourage firms to review their practices, even without the FCA setting further regulatory expectations.
- The deadline for responses to DP23/1 is 10 May 2023.
- The FCA will use the feedback in considering what the industry would find most helpful in this evolving area. The feedback will also help the FCA consider in what direction it should take its future regulatory approach. The FCA will also consider firms' arrangements in many of these areas as part of its supervisory engagement with firms.

Dec 23 EUA 90.28

- EUA prices have backed down from the strong rally that started a few weeks ago. All-time highs were within reach last Wednesday, however EUAs stopped just 4 EUR before that, at around 97.50 EUR on December 2023 contract. Reversal was swift, with prices already losing 6 EUR the next day. The weakness was partly attributed to tomorrow's European Parliament environment committee vote on reforms.
- This would frontload around 250 million EUAs from the MSR until 2026 and bring more supply to daily auctions. Revenues would be used to speed up green transition and move away from Russian fossil fuel dependence. Another reason for fast reversal could be the end of short squeeze as it was seen from the commitment of trader's report. Data showed that investment funds that were previously net short around 9 million EUAs three weeks ago, bought back all those shorts and ended up long by 1 million EUAs. Changes like this have material impact on the market. One sided interest coupled with relatively empty order books mean that ranges of those moves can be extreme. With temperatures warming up again and the coldest part of the winter behind, selling pressure could start building up again in all energy markets.
- German power prices are down by 21.5 EUR since last week, with the front year contract trading at 163.5 EUR/MWh. API2 coal prices are down by 18 USD since last week, with the Cal23 contract trading at 135 USD/tonne. EUR/USD is down by 190 points since last week and is currently trading 1.0730.

ISDA responds to FCA consultation on sustainability disclosure requirements and investment labels; *On January 25, ISDA responded to the Financial Conduct Authority's (FCA) CP22/20 consultation on sustainability disclosure requirements and investment labels.*

- ISDA supports the approach the FCA is taking to use derivatives in sustainable investing, notably to avoid making rules specifically relating to derivatives in the first instance. The response recommends that the FCA monitors developments in the market and implements guidance to increase transparency on the use of derivatives in sustainable investment products.

- ISDA advocates for the FCA to pursue a principles-based approach to setting out sustainability disclosure requirements and investment labels, bearing in mind the importance for firms of international coherence and interoperability of rules.
- The consultation response also outlines the role of derivatives in sustainable finance, including new products such as sustainability-linked derivatives.