

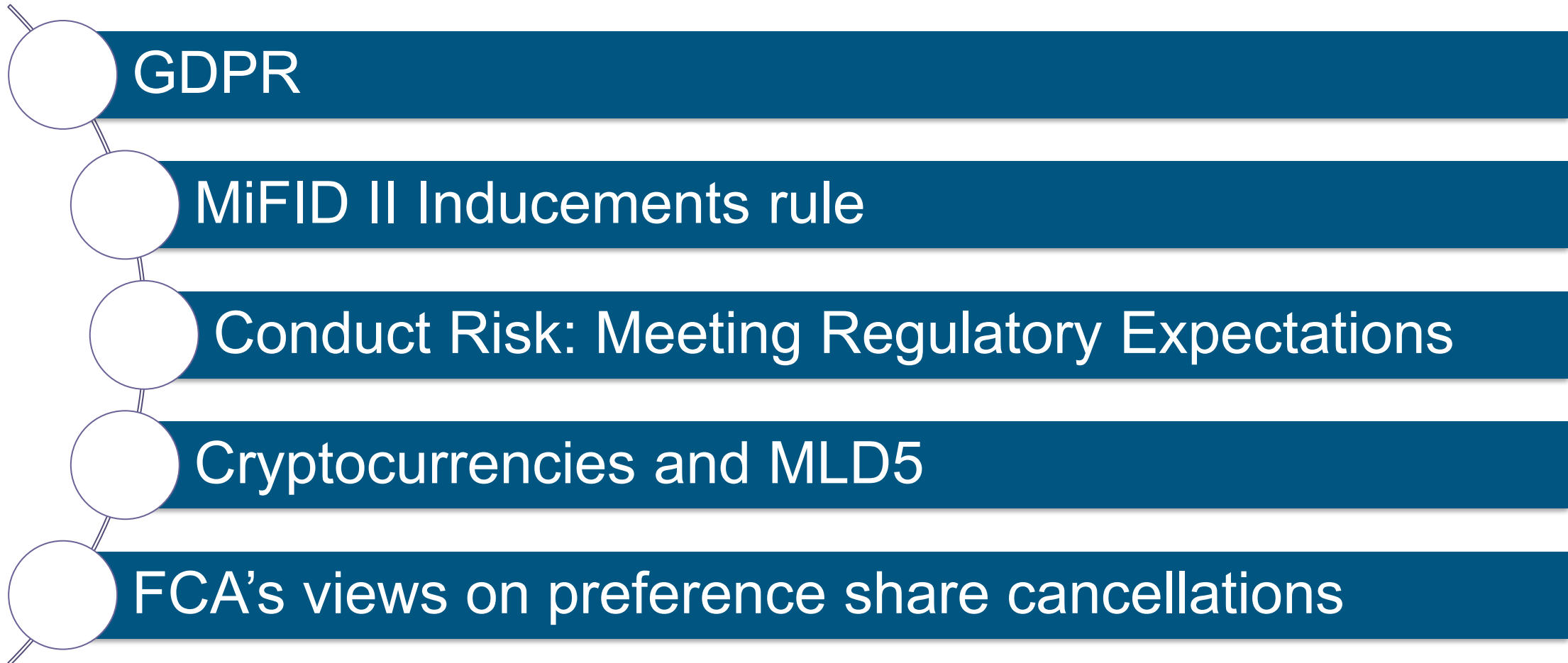
A blue-toned background image featuring a financial line chart with multiple data series and a grid. The chart shows various trends, including a sharp decline followed by a recovery and another decline.

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9 May 2018

Financial Regulation Monthly Breakfast Seminar

Overview

- 
- GDPR
 - MiFID II Inducements rule
 - Conduct Risk: Meeting Regulatory Expectations
 - Cryptocurrencies and MLD5
 - FCA's views on preference share cancellations

A blue-toned background featuring a financial line chart with multiple data series and a grid. The chart shows various peaks and troughs, with some lines appearing thicker than others. The overall aesthetic is professional and data-oriented.

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GDPR
Gail Crawford

A Quick Legal History: What is the GDPR?

Effective Date:
May 25, 2018

DPD

- EU Data Protection Directive agreed in 1995
- E-Privacy Directive regulates use of Telco data and tracking technologies
- Indirect implementation by way of national legislation
- Patchwork of laws: 28 different interpretations

Goal: *Establish single pan-European law to replace and modernize current patchwork of national laws*

GDPR

- Automatic application in all Member States
- Will directly replace all national laws
- Aims to be tech neutral
- Revised E-Privacy Regulation that regulates tracking technologies also targeted for same date

Severe non-compliance risks:
Fines up to 4% of global turnover

GDPR Implementation Process

- With around 2 weeks to go, we still have no national law in the majority of countries - local counsel expect deadline to be missed
- Some “fudges”:
 - Belgium has done a basic implementation, but expects to pass detailed derogation legislation post-deadline
 - Italy has made some legislative changes and provided guidance, but still waiting on main draft
- What does this mean?

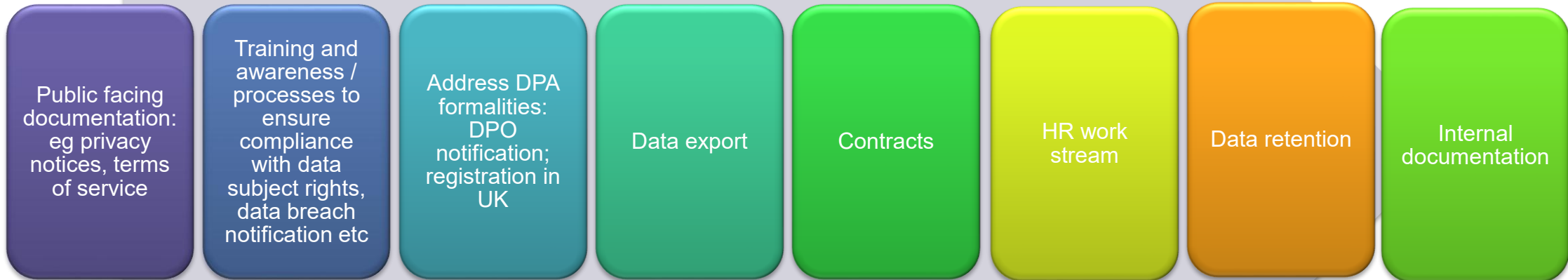


What if the laws are not passed in time?

- Direct effect of GDPR
- What does that mean for national laws?
- What does that mean for regulators?
- What does that mean in reality?
- What about EEA countries e.g. Norway, Iceland and Liechtenstein
- Power of the supervisory authorities
- What variances and issues are we seeing

What is a must have on May 25th....

MUST HAVES



TO-DOs

Enforcement after the 25th

- What do we expect:
 - A few test cases?
 - DPA enforcement priorities?
 - How big will the fines be?
 - Class actions?
- Mitigation steps:
 - Document plan and key decisions
 - Show path to full compliance
 - Monitor decisions, cases and guidance

The background of the slide is a blue-tinted financial chart. It features a grid of dashed lines and several data series represented by lines of varying thickness and styles (solid and dotted). The lines show fluctuating trends, with some showing a general downward slope and others showing more complex, jagged patterns. The overall aesthetic is professional and data-oriented.

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MiFID II Inducements rule

Rob Moulton

Overview

- Are you confused by the MiFID II inducements rule?
 - It isn't only about inducements
 - It overlaps with several other rules
 - It applies differently to different services
 - It has been overshadowed by research unbundling
 - It contains elements FCA brought in prior to MiFID II

The Other Rules

- Clients' best interests rule
 - Act honestly, fairly and professionally in accordance with the best interests of clients
- Conflicts of interest rule
 - Identify, prevent and manage conflicts of interest
 - Implement effective organisational requirements
 - Disclose (as a last resort)

The Inducements Rule(s)

- General inducements rule
 - Do not pay or receive money or benefits unless
 - Payment designed to enhance quality of service
 - No inherent conflict
 - Disclosure (by someone)
 - Needs a third party (does not apply to client interactions)
- Portfolio management and independent investment advice rule
 - Do not receive benefits other than Minor Non-Monetary Benefits
 - More detail under MiFID II on trail commission, and what needs to be done to earn it
- Research unbundling
 - Do not give or receive research for free (with caveats)
- Payment for order flow
 - Those routing client orders should not receive, and those accepting those orders should not pay, for that order flow

Capital Markets Example

- Investment bank underwriting / placing securities on behalf of corporate clients to investors
- Receives a fee from corporate and commissions from investors
- General inducements rule applies to receipt
- Either one or two clients
 - Corporate Finance Contacts
- Are the “two” transactions separate or part of a single service to the corporate?
- Disclosure of commissions / fees
 - To corporate if CFC exemption used
 - To both sides if not

Manufacturing and Distribution Example

- Manufacturer makes product (e.g. structured note)
- Sells to Distributor for onward sale to investors
- From the Manufacturer's view
 - There is no third party, just a client
 - Fee from Distributor is not an inducement, but is a cost and charge
- From the Distributor's view
 - The Manufacturer is a third party to the relationship they have with their client
 - Fee received by Distributor must pass the tests in the general inducements rule
 - If Distributor is also manager/advisor, the manager/advisor rule also applies
 - Potentially also PFoF

Corporate Access Example

- Sell-side firm arranges for investors to meet corporate client
- Corporate Finance Contact regime not really applicable
 - May not be corporate finance business being undertaken
 - May not be possible to make CFC disclosure
- From the sell-side point of view
 - General inducement rule applies as it may be seen as offering benefit to buy-side firm that relates to business undertaken for corporate
 - Unlikely to be an issue if it is clear the sell-side firm is acting for the corporate
- From the buy-side point of view
 - General inducement rule and manager/advisor rule applies
 - Have to assess event as MNMB or pay to attend
 - More likely to be minor if lots of attendees, organised for benefit of corporate etc.

Hospitality Example

- Sell-side firm provides hospitality to buy-side firm
- Same rules analysis as corporate access above
 - But, additionally, reasonable de minimis hospitality is expressly provided as allowable, unlike corporate access
- Very different approaches in the market
 - IFAs etc., this seems to be dying out given retail nature of business
 - Reputational risk, as much as any rule change, may be driving behaviour



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Conduct Risk: Meeting Regulatory Expectations

David Berman

FCA's Approach

Questions

1. What proactive steps do you take as a firm to identify the conduct risks inherent within your business?
2. How do you encourage the individuals who work in front, middle, back office, control and support functions to feel and be responsible for managing the conduct of their business?
3. What support (broadly defined) does the firm put in place to enable those who work for it to improve the conduct of their business or function?
4. How does the Board and ExCo (or appropriate senior management) gain oversight of the conduct of business within their organisation and, equally importantly, how does the Board or ExCo consider the conduct implications of the strategic decisions that they make?
5. Has the firm assessed whether there are any other activities that it undertakes that could undermine strategies put in place to improve conduct?

Practicalities

- No “one-size-fits-all” model
- Regular self-assessment
- Governance
- Questions?



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Cryptocurrencies and MLD5

Nicola Higgs

FCA Statement

Some helpful statements from the FCA:

“...we do not consider cryptocurrencies to be currencies or commodities for regulatory purposes under MiFID II.”

“Cryptocurrency derivatives are, however, capable of being financial instruments under MIFID II.”

<https://www.fca.org.uk/news/statements/cryptocurrency-derivatives>

Crypto Regulatory Environment

EUROPE

- Statements from all major regulators that ICOs will need to comply with securities laws where applicable
- Useful statements from the UK FCA, providing clarity on whether a cryptocurrency is a commodity, currency or derivative, and implications of that categorisation
- Specific regulatory regimes being developed in Gibraltar and Malta to attract business
- German BaFin treats cryptocurrencies as a 'unit of account', which is a financial instrument
- Swiss regulator has put out specific guidance

USA

- Ever-tightening market
- CFTC treats cryptocurrencies as a commodity, making non-spot deliveries derivatives
- Comments from Jay Clayton (SEC Chairman) during a senate hearing: "I believe every ICO I've seen is a security"
- SEC enforcement actions e.g. Munchee – prevention of the sale of tokens and ordered the return of funds
- Transferability issues: secondary market trading made difficult by statutory lock-up periods

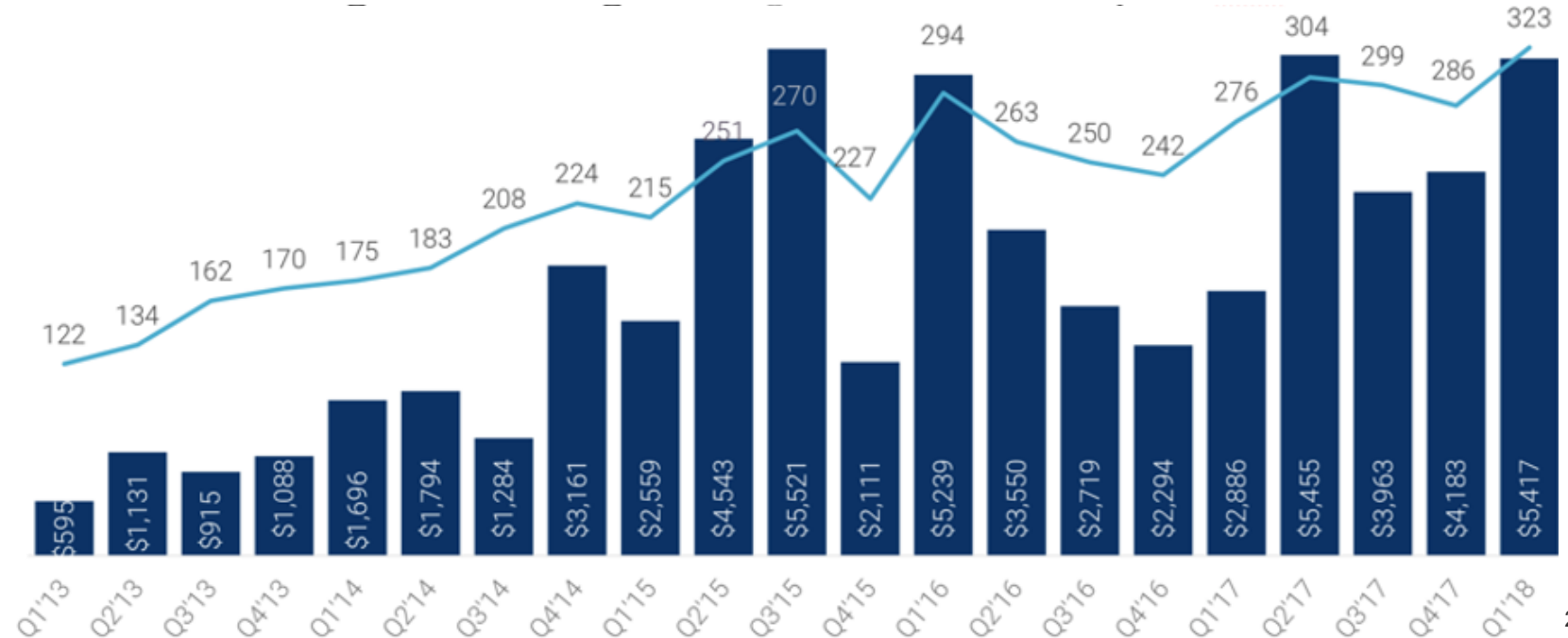


ASIA

- Chinese prohibition on ICOs
- South Korea prohibition on ICOs (potential relaxation of this)
- Hong Kong – increasing regulatory intervention, with HK SFC enforcement actions
- Japan – crypto exchange licensing regime and potential ICO licensing regime

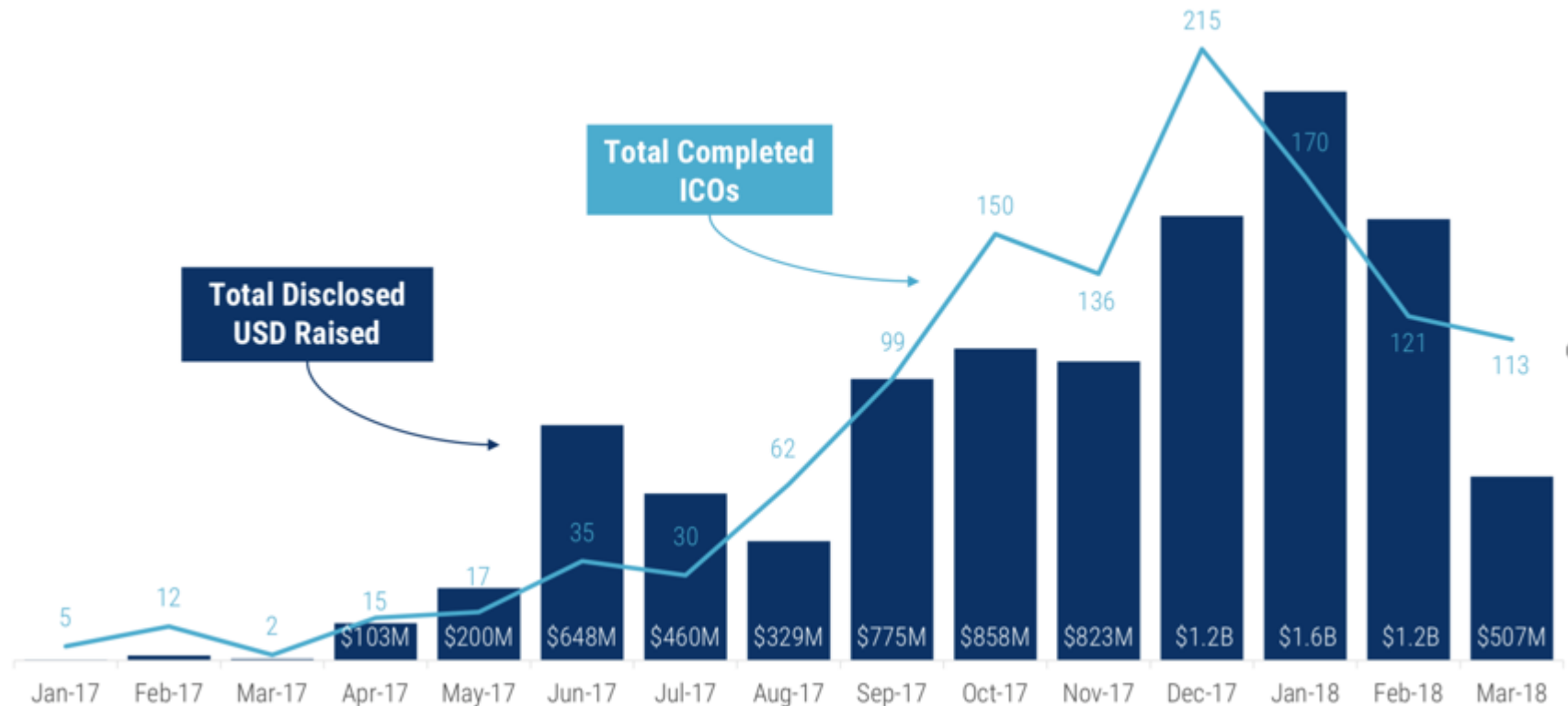
Crypto & FinTech Stats

- ICOs Set Record Quarter, Raising \$3.3Billion
- Global investment in FinTech companies has hit a new high with 323 deals closed during the first quarter of this year, the highest level since data began
- \$5.4 billion has been raised so far in 2018, compared to \$2.8 billion during the same period last year, a near 50% increase according to CB Insights' Global Fintech Report Q1 2018



Crypto & FinTech Stats

- ICOs are not far off from having raised as much as all FinTech companies, setting a record first quarter at \$3.3 billion
- January set a new high at \$1.6 billion for 170 ICOs, with the sector then slightly slowing down, but still raising half a billion in March for 113 projects



MLD5

- The European Parliament and Council have signed off on the text of the fifth Anti-Money Laundering Directive (known as MLD5)
- Will require virtual currency exchange platforms (between virtual currencies and fiat currencies) and custodian wallet providers to perform due diligence on their customers, including KYC checks
- Such entities will also need to be registered for AML purposes
- Member States will have 18 months to implement the new measures, so the sector will not feel the full impact of the changes for some time

Do All Virtual Currencies / Tokens Fall Within Scope?

- Virtual currencies are defined as a digital representation of value that:
 - Is not issued or guaranteed by a central bank or a public authority
 - Is not necessarily attached to a legally established currency, and does not possess a legal status of currency or money
 - Is accepted by natural or legal persons as a means of exchange
 - Can be transferred, stored, and traded electronically
- This definition is very broad and the recitals to the directive confirm that the objective of MLD5 is to cover all the potential uses of virtual currencies. Therefore, it is likely that all cryptocurrencies and most tokens issued in an ICO will be covered by the definition

The Issue of Anonymity

- A large part of the virtual currency environment will remain anonymous, as users can also transact without providers engaged in exchange services between virtual currencies and fiat currencies, presumably on an over-the-counter basis or using an exchange that only allows crypto-to-crypto transfers
- MLD5 proposes that a central database registering users' identities and wallet addresses is established and made accessible to national Financial Intelligence Units. However, this proposal will only be introduced via separate legislation if the European Commission determines it necessary and appropriate following its report on the implementation of MLD5, which is due to be published within two years of the transposition of MLD5

Application to Custodian Wallet Providers

- A custodian wallet provider is defined as an entity that provides services to safeguard private cryptographic keys on behalf of its customers, to hold, store, and transfer virtual currencies
- This definition will capture standalone crypto-custodians and wallet providers, but likely will also capture any blockchain platform that provides customers with a digital wallet for holding tokens, even if this is an ancillary part of the blockchain platform's business

Impact on ICO Issuers?

- ICO issuers will only fall within the scope of the new MLD5 requirements if they satisfy the definition of a custodian wallet provider by safeguarding the private keys of their tokenholders / platform users, or if they provide services to convert tokens into fiat currency
- However, regardless of this determination, ICO issuers should consider carefully whether their broader activities fall within the scope of AML requirements, and the possible legal, business, and reputational risks of failing to conduct adequate AML/KYC checks on purchasers of tokens and users of their platform

A blue-toned background featuring a financial line chart with a grid. The chart shows two data series: a solid blue line and a dotted blue line. The solid line starts high on the left, dips, rises, dips again, and then rises sharply towards the right. The dotted line starts high, dips, and then trends downwards. The overall aesthetic is professional and data-oriented.

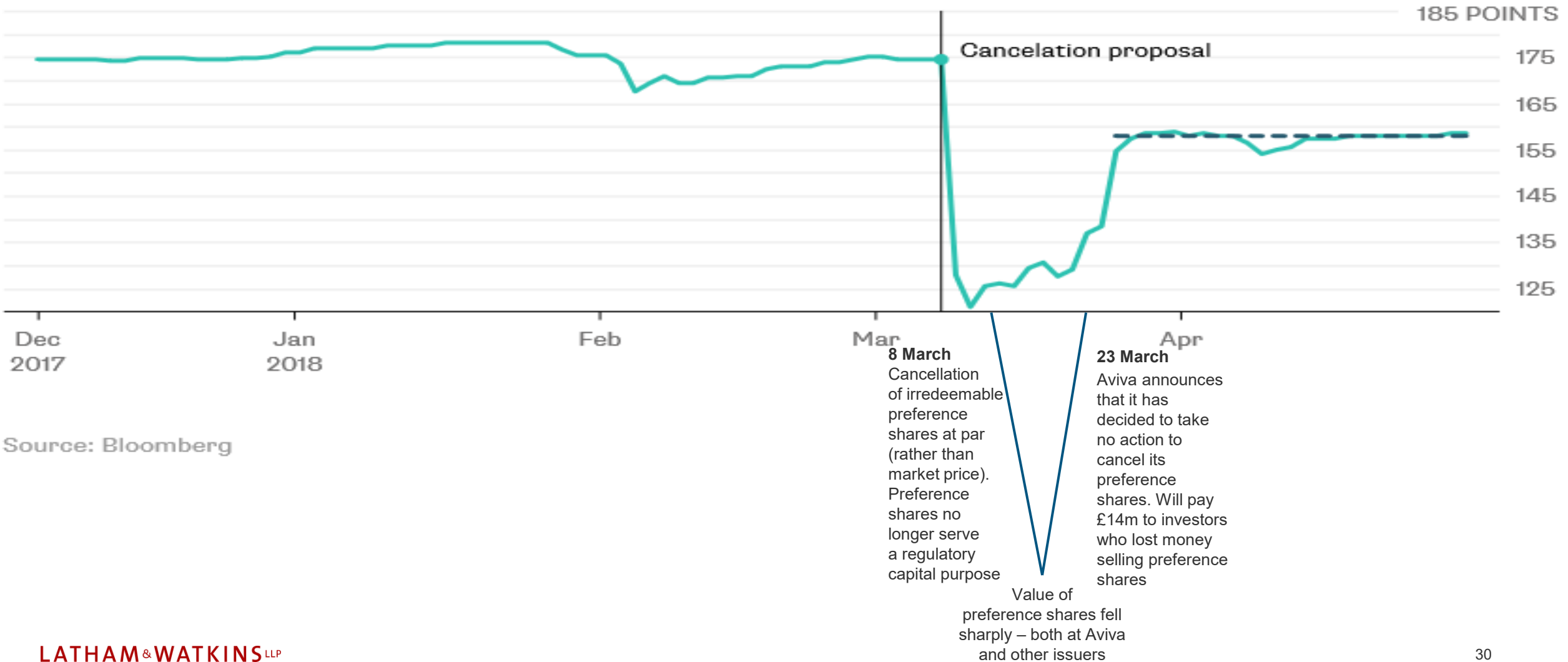
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FCA's views on preference share cancellations

Nicola Higgs

Aviva: FCA Letter to HMT

● Aviva 8.75% preferred shares



HMT asked FCA to consider:

- Was management assertion that shares could be cancelled at par with approval of ordinary and preference shareholders voting as a class communicated in a many consistent with LRs / DTRs?
- Was management intention to cancel consistent with LRs and DTRs?
- Does the fact that the shares were originally marketed to retail investors alter FCA's approach to this issue? Was information related to redeemability misleading?

HMT asked FCA to consider:

- What is FCA's role in resolving any dispute as regards whether the shares are redeemable?
- How far does the fact that Aviva plc has FCA regulated subsidiaries alter its approach to this issue?
- What options are available to FCA to address concerns about the functioning of the wider market for preference shares, including concerns about redeemability?

FCA:

- “We see value in a broader review of the legal issues that this case has raised along with consideration of how best to ensure a market wide understanding of the rights and terms of preference shares”
- Issuers must make clear whether their preference shares can be redeemed at less than market price
- Ultimate decision on the pursuit of this course of action lies with the company BUT action in the form suggested would have involved:
 - A special resolution
 - Application to the high court seeking confirmation of the reduction

FCA:

- No public comment on Aviva's compliance with its regulatory obligations (due to listed company status)
- No formal investigation. Review to understand whether there are circumstances that might require an investigation under MAR

Key message: Sound legal advice is not enough – do not ignore how the market will respond



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Questions?