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BANKING BITES – NOVEMBER 10 2022

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SUMMARY

Welcome to Banking Bites! This is our short summary flagging some key developments in your sector that we hope will inform your activities in your market.

This edition covers:

1. Future regulatory framework for cryptoasset activities

2. NY DFS Fines Bank for third party loan pricing discretion, disparate impact

3. New UK rules proposed to tackle greenwashing

4. Regulator scrutinises the competition impacts of Big Tech in retail financial services sectors

5. Revised Wolfsberg Financial Crime Principles for correspondent banking

6. UK Parliamentary Committee calls for new failure to prevent fraud offence

7. Further changes to sanctions landscape

8. UK's Commercial Court hands down judgments in COVID-19 business interruption cases

1. FUTURE REGULATORY FRAMEWORK FOR CRYPTOASSET ACTIVITIES

The Financial Stability Board has published comprehensive proposals for the regulation and supervision of crypto-asset activities for G20 Finance Ministers and Central Bank Governors. The proposals cover recommendations to promote consistent, comprehensive regulatory and supervisory approaches to crypto-asset markets and activities. Alongside the proposals, it also published a review of the FSB's recommendations from October 2020 for the regulation, supervision and oversight of global stablecoin arrangements. The FSB invites comments on the proposed recommendations. Responses can be sent to fsb@fsb.org by Thursday 15 December 2022.

Meanwhile, in the UK, an amendment has been tabled to the Government's Financial Services and Markets Bill ("FSMB") that, if passed as drawn, opens up the possibility of a regulatory framework around activities related to cryptoassets based on where the activity takes place, rather than where the cryptoasset business is based. The FSMB includes provisions to create a new designated activities regime to enable activities related to financial markets to be regulated within a FSMA-compatible framework. The amendment, which has been agreed, seeks to bring cryptoasset activities within the scope of the new designated activities regime. The draft bill is accessible online.

For further information, please contact Polly James.

2. NY DFS FINES BANK FOR THIRD PARTY LOAN PRICING DISCRETION DISPARATE IMPACT

The New York Department of Financial Services ("NY DFS") recently fined a NY State Chartered Bank close to $1MM arising from the pricing discretion given to third parties in connection with indirect lending. The Consent Order finds that the bank's indirect automobile lending policy expressly permitted third party pricing discretion known as Dealer Mark-ups which could result in as much as 2% increase in consumer loan interest rates. The NY DFS investigation, which was based on Bayesian Surname Geocoding (BISG) assessment methodology in the absence of borrower loan race or national origin data, found that during the relevant time period "Black, Hispanic and Asian borrowers, on average, paid more in discretionary Dealer Markups than non-Hispanic white borrowers," ranging at various periods from 15 basis points to 39 basis points. While the NY DFS acknowledged that no evidence of intentional discrimination was found, the NY DFS held the bank responsible because its policies permitted the pricing discretion and for much of the relevant period did not monitor lending data to identify and mitigate any potential disparate impacts based on race or national origin. The Consent Order requires restitution to impacted consumers and adoption of a compliance plan to enhance compliance with federal and state fair lending laws, including imposing caps on Dealer Markups, annual notice to third parties regarding ECOA and fair lending compliance and increased monitoring for disparities, among other things.

At the federal level, the CFPB also has approved of the use of BISG in assessing potential financial services products and services disparities in the context of Office of Research (OR) and Division of Supervision, Enforcement and Fair Lending (SEFL). If you have not, consider reviewing the CFPB methodology paper on information proxy for unidentified race and ethnicity. While the issue of proxy information utilization is far from new, we may expect increased utilization of public proxy information in a variety of financial services contexts whether race and ethnicity date is not required to be collected. This consent order should serve as a reminder that the bank policy risk impact may extend beyond the bank's actions and be exacerbated by business partners/ third parties. Regulators, consumers and potential litigants are keenly focused on ESG-related principles including social justice, equity and inclusion. As financial services companies expand product offerings and enter into new strategic partnerships with third parties to deliver services, focus on

compliance risk, including monitoring third parties and analyzing impacts (including potentially through public proxy information) may be key to mitigating fair lending risks.

3. NEW UK RULES PROPOSED TO TACKLE GREENWASHING

The UK's financial services watchdog, the Financial Conduct Authority ("FCA"), has published a consultation paper on new measures designed to protect customers from greenwashing. The proposed rules include sustainable investment labels, disclosure requirements and greater restrictions on how firms label and market products using sustainability-related terms. This paper is the latest in the FCA's attempts to improve trust in sustainable investment products and support the Government's Green Finance Roadmap to Sustainable Investing, published in October 2021. While any new rules will not come into force until June 2024, it is clear that the regulator remains invested in regulating how sustainable financial products are labelled, disclosed and sold and firms should continue to ensure that any sustainability credentials they use are accurate and well-informed.

For further information, please contact Matthew Baker or Rhys Corbett.

4. REGULATOR SCRUTINISES THE COMPETITION IMPACTS OF BIG TECH IN RETAIL FINANCIAL SERVICES SECTORS

The FCA has published a discussion paper seeking to explore the potential competition impacts of Big Tech's entry and expansion into retail markets. While the regulator recognises that, in the short term and potentially medium term, the entry of Big Tech into the market could be beneficial for many consumers, it is concerned that such benefits may be eroded in the longer term due to anticompetitive practices or the incentives to exploit market power. The FCA seeks the views of regulated financial services firms to inform the development of an effective competition approach for Big Tech firms and to understand where the greatest benefits and risks to competition lie. Comments can be sent to the FCA by email to DP22-05@fca.org.uk by 15 January 2023. The FCA also issued a press release.

Please contact Andrew Hockley and Victoria Newbold if you would like further information.

5. REVISED WOLFSBERG FINANCIAL CRIME PRINCIPLES FOR CORRESPONDENT BANKING

On 28 October, the Wolfsberg Group published updated Financial Crime Principles for Correspondent Banking, replacing the 2014 Wolfsberg Anti-Money Laundering Principles for Correspondent Banking. The Principles set out how correspondent banks can effectively assess the risks in correspondent banking relationships and how those risks may apply to respondent banks. The Group has agreed that the updated Principles will constitute global guidance on the establishment and maintenance of cross-border correspondent banking relationships. Firms should incorporate the updated Principles into their risk management and due diligence processes systems and controls to ensure they are meeting best practices.

To discuss how this might impact you, speak to Oran Gelb and Andrew Tuson.

6. UK PARLIAMENTARY COMMITTEE CALLS FOR NEW FAILURE TO PREVENT FRAUD OFFENCE

On 18 October 2022, the House of Commons Justice Committee published its report 'Fraud and the Justice System'. According to its findings, fraud has become the most commonly experienced crime in England and Wales. The Committee recognised that the most effective way to tackle fraud is to prevent it from occurring. The private sector plays an increasingly important role in this and we can expect a new Fraud Action Plan to be published shortly by the UK's Government, setting out the roles and responsibilities of all those involved. The Committee also summarised the evidence it had received calling for a failure to prevent fraud offence and concluded that it would focus private sector effort on preventing fraud. The Committee backed calls for the Government to introduce a failure to prevent offence to hold companies to account for fraud occurring on their systems. Financial institutions remain at the forefront of the fight to reduce fraud and would be significantly impacted by the introduction of a new failure to prevent offence.

7. FURTHER CHANGES TO THE UK'S SANCTIONS LANDSCAPE

In the UK, the Russia (Sanctions) (EU Exit) (Amendment) (No. 15) Regulations 2022, SI 2022/1110 largely came into force on 29 October 2022, amending The Russia (Sanctions) (EU Exit) Regulations 2019. Regulation 6, which prohibits the import of liquefied natural gas from Russia, comes into force on 1 January 2023. The instrument places further restrictions on trade and expands the prohibition on the export, supply, delivery and availability of financial services, funds and brokering services to Russia. In addition, the instrument expands the prohibition of providing loans to certain companies connected with, or owned by persons connected with, Russia. In particular, it creates a new category of loan and brings companies outside Russia owned by a person connected with Russia into scope, and includes UK companies. The Russia (Sanctions) (EU Exit) (Amendment) (No. 16) Regulations 2022 (SI 2022/1122) made on 3 November 2022 will come into force on 5 December 2022. This instrument prohibits the supply or delivery by ship of 2709 and 2710 oil and oil products from a place in Russia to a third country, or from one third country to another third country. The instrument also places a prohibition on the provision of financial services, including insurance, that facilitates the supply or delivery of 2709 and 2710 oil and oil products. Financial institutions should ensure that their services are not affected by the new prohibitions and comply with the amended regulations.

For further information on sanctions, please contact Chris Bryant or Sonja Hainsworth.

8. UK'S COMMERCIAL COURT HANDS DOWN JUDGMENTS IN COVID-19 BUSINESS INTERRUPTION CASES

A UK court has delivered three significant judgments considering the aggregation of business interruption losses arising from COVID-19 on 17 October 2022: *Stonegate v MS Amlin and others, Various Eateries v Allianz, and Greggs v Zurich*. The primary issue addressed in all three judgments was the extent to which UK business interruption losses "*arise from, are attributable to or are in connection with a single occurrence*" – a critical phrase since insurers provided a limit of liability for each occurrence. If there was one occurrence (e.g. a pandemic) only one limit of liability would be payable, but if there were many occurrences (individual infections in the vicinity of each business closed down) then many limits of liability would be payable. The impact on the value of the claim was stark: c.£1.2bn on Stonegate's case versus c.£17m on the insurers' case.

An "occurrence" or "event" in the context of COVID is of particular interest to the reinsurance market as reinsurance contracts often provide limits of indemnity and apply policy excesses by reference to an "occurrence" or "event", so these decisions are expected to have broader relevance.

The insurers collectively advanced several theories on what might amount to a single occurrence. The court found that the following could be single occurrences: (a) an initial "spillover" or first human infection at Huanan Market in Wuhan, (b) a first transmission of COVID-19 infection in the United Kingdom (or any other individual infection for that matter, following the Supreme Court's decision as to what constitutes an "occurrence" in the context of COVID-19), and (c) a particular government measure or announcement. Only the latter, government lockdowns, had a sufficient causal connection with the losses to permit the insureds to aggregate their UK business interruption losses.

Various other points were raised in the three judgments that are of relevance to the insurance market. On causation, the Court in *Stonegate* concluded that only losses suffered up until 4 July, 6 July and 13 July 2020 in England, Scotland and Wales respectively were caused by COVID-19 cases occurring within the period of insurance ending April 2020. On government support, the Court in *Stonegate* and *Greggs* concluded that furlough payments received by businesses during the pandemic had to be taken into account when quantifying the business interruption loss.

At least one of the judgments is expected to be appealed, so we do not expect these decisions to be the final word.

BCLP previously wrote an insight on this topic. To discuss the issues raised, please contact Anthony Lennox, Jonathan Sacher or James Fairburn.

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