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Research and commentary on regulatory and other financial services topics

From Endeavor Square to the Rocky Mountains

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The UK's Financial Conduct Authority Discusses Gaps in Firms' Surveillance for Market Abuse

May 16, 2024

By Alix Prentice
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The UK's Financial Conduct Authority (FCA) has reported its observations on firms' market abuse surveillance arrangements in the **May edition of Market Watch**. The newsletter looks at a peer review of surveillance model testing and examples of malfunctions the FCA has seen in practice in firms' systems for monitoring and detecting market abuse, and how firms review and deal with the functioning of these monitoring and surveillance systems.

Examples of surveillance system failures given include:

- Incomplete implementation of a firm's flagging system that was not picked up because the firm did not undertake testing – if it had, it would have seen that the news feed had not been activated, meaning that alerts for insider dealing were not being generated over a period of three years because they were lacking complete information.

- Incorrect coding of an insider dealing alert trigger, requiring the firm to trade in the instrument on the day that the price moved outside a defined threshold. For less liquid instruments, there was a real risk that insider dealing could be missed due to this incorrect trigger.

- A firm offering direct market access failed to capture trade data when it connected clients directly to the trading venues (rather than offering connectivity through the firm itself).

On its 2023 peer review of firms' testing of automated surveillance models, while the FCA found that most firms had formal procedures for testing and did perform some form of it annually, the FCA has felt the need to set out various steps to avoid surveillance failures. These include making sure that data governance is thorough enough to make sure sufficient, accurate data is being captured. Model testing should be similarly thorough and effective, with new models being robustly interrogated before implementation. Finally, governance arrangements should be sufficiently resourced so as to deliver timely, efficient and effective outcomes. Firms are encouraged to review their arrangements and make changes where necessary.

Why You Should Care About Colorado Attempting to Opt-Out of DIDMCA

May 16, 2024

By Mercedes Kelley Tunstall
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Yesterday, a preliminary injunction hearing was held that will decide whether industry trade associations can halt aspects of Colorado's attempt to opt-out of the usury exportation provisions of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA), 94 Stat. 132, 164-65 (1980). Thanks to DIDMCA, for the last 44 years depository institutions other than national banks – including federally insured state banks, savings banks and state-chartered, federally insured credit unions – have been able to engage in interstate lending in parity with national banks. The court case being brought by the National Association of Industrial Bankers, the American Financial Services Association and the American Fintech Council (Plaintiffs) against Colorado's Attorney General, Philip J. Weiser, in the United States District Court for the District of Colorado seeks to challenge **a new law in Colorado** (with an effective date of July 1, 2024) that purports to "limit the interest rates and fees that out-of-state state-chartered banks may charge on loans they make outside Colorado's borders to Colorado residents." *See, Plaintiffs' Motion for Preliminary Injunction.* Should the new law go into effect in July, all lenders out-of-state, except national banks, will be required to limit their interest rates to Colorado's interest rate caps, placing them at a competitive disadvantage and making it "economically impracticable for Plaintiff's members to offer these products to those Colorado consumers who ... have less access to credit generally. At the same time, national banks will still offer these same products at rates above Colorado's caps ... Coloradans will lose choice but not gain the States supposed protections." *Ibid.*

While DIDMCA does allow a state to re-impose its own usury rates for loans made by depository institutions chartered in Colorado to Colorado residents (i.e., to opt-out of DIDMCA), at issue is whether a loan "made in" Colorado means loans made by the depository institutions that are physically in Colorado, or whether a loan "made in" Colorado also includes loans made to Colorado borrowers. The Colorado Attorney General and the Administrator of the Colorado Uniform Consumer Credit Code **have stated** that the new law means that loans that are "made in" Colorado do indeed include all loans made to Colorado borrowers. The industry trade associations argue otherwise.

Joining the fray, the FDIC filed an amicus brief in the case, supporting the Colorado Attorney General and Administrator on April 23, 2024, prompting the American Bankers Association (ABA) and the Consumer Bankers Association (CBA) to **file their own amicus brief** in response. Effectively, the ABA and CBA reject Colorado's interpretation of when a loan is "made in" Colorado, as well as the FDIC's endorsement of that interpretation, noting that "the FDIC has argued for the very first time" that, "loan transactions between parties in different states are made in the state where the borrower enters into the transaction just as much as they are made in the state where the lender enters the transaction." The ABA and CBA proceed to argue that because the FDIC does not point to any prior FDIC "regulation, rule, or opinion letter, their amicus brief should be given deference by the court, citing a particular on-

point Supreme Court case, *U.S. v. Mead Corp*, 533 U.S. 218, 228 (2001), “near indifference” is properly accorded to an agency “interpretation advanced for the first time in a litigation brief.”

Indeed, should the Colorado Attorney General’s interpretation of the new Colorado law be allowed to going into effect, the ability for depository institutions that are not national banks to engage in interstate lending could quickly become limited, as other states are looking to adopt similar provisions. This could, in turn, negatively impact the amount of consumer credit being extended, in general, and also could discourage any secondary market activity in consumer credit portfolios.

The CFPB and NCSLT TRUSTS Saga: Movement on the Third Circuit Case and a Second CFPB Enforcement Action

May 16, 2024

As we reported in our **Client and Friends memo last month**, the Third Circuit published an opinion on March 19th finding that statutory trusts such as those that make up the National Collegiate Student Loan Trusts (the NCSLT Trusts) are “covered persons” for purposes of the Consumer Financial Protection Act (CFPA). We warned that this decision would likely be a precursor to more enforcement actions by the Consumer Financial Protection Bureau (CFPB) against statutory trust structures.

Read more **here**.

The New UK Securitisation Rules: A Practical Overview and Comparison

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On April 30, the FCA and PRA released their final rules on securitizations, scheduled for implementation on November 1, 2024. The rules represent the finalization of the process of adoption of EU-derived legislation and technical measures into the regulators' rulebooks. While changes to existing requirements are subtle, the memo highlights important areas of divergence between the UK and the EU that will affect issuers and investors. Read more **here**.