

## IMPLICATIONS FOR FINANCIAL SERVICES FIRMS OF THE CMA'S NEW POWERS TO REGULATE DIGITAL MARKETS AND TO ENFORCE COMPETITION AND CONSUMER PROTECTION LAWS

The UK Parliament is currently considering the Digital Markets, Competition and Consumers Bill which will impact financial services firms. The legislation will introduce a new regulatory regime for digital markets to be enforced by the Digital Markets Unit (**DMU**) in the Competition and Markets Authority (**CMA**), with input from financial regulators. It will also lead to changes to competition laws including mergers, market inquiries, antitrust investigations and litigation.

### WHAT WILL THE BILL DO?

The Bill will implement three broad categories of reform:

- introducing an ex-ante regulatory regime for businesses that are active in digital markets and have "Strategic Market Status" (**SMS**), to be enforced by the DMU with connected rights for the Financial Conduct Authority (**FCA**), Bank of England (**BoE**) and the Prudential Regulation Authority (**PRA**);
- effecting various changes to UK competition laws regarding the behavioural antitrust prohibitions on anticompetitive agreements and abuse of dominance, merger control and market investigations; and
- reform consumer protection laws by giving the CMA powers to impose civil penalties for their breach without having to seek a court order first and by creating certain new prohibitions to regulate subscription traps, consumer saving schemes and fake reviews.

### THE DIGITAL MARKETS UNIT

The DMU's new powers are intended to equip it to act swiftly in response to rapidly-evolving digital sectors, with the core purpose of addressing both the sources of market power and the economic harms that result from the exercise of that market power. The Bill confers powers on the CMA to charge a levy on SMS firms to fund the DMU's activities. This may sound familiar to financial services firms who pay levies to the FCA and PRA.

The DMU will be tasked with implementing and enforcing a code of conduct for businesses, or parts of businesses, that will be designated as having SMS. It will also have the power to impose so-called pro-competitive interventions

### Key issues

#### Digital markets proposals

- How will the DMU assess whether businesses have Strategic Market Status?
- How will the DMU's code of conduct be designed and enforced?
- What will be the DMU's powers to implement pro-competitive interventions to address the root causes of market power?
- What will be the role for financial regulators?
- Which mergers involving SMS firms will have to be notified to the CMA?

#### Competition regime proposals

- What will the new jurisdictional thresholds be?
- What procedural reforms are in store for the merger and markets regimes?
- What new investigation and remedy powers are proposed for the CMA?

#### Consumer regime proposals

- How will the enforcement of consumer protection laws be reformed?

(PCI) on SMS businesses to tackle the underlying sources of market power and promote competition. This follows the FCA publication of a Discussion Paper in October 2022 on the potential competition impacts of "Big Tech" firms' entry and expansion in retail financial services.

### **How will Strategic Market Status be assessed?**

Under the Bill, SMS designation will not require formal market definition for a robust assessment of market power. Instead, the DMU will consider firms' provision of 'digital activities', being services provided by means of the internet, electronic communications services or digital content (in each case including those services that are provided free of charge). If carried out in combination (by reference to the nature of the activity, brand names or both), two or more activities could be treated as a single activity.

SMS designation will be subject to a turnover condition of worldwide turnover of £25 billion or UK turnover of £1 billion and will also require a finding of both substantial *and* entrenched market power (based on a forward-looking assessment of a period of at least five years), and a position of strategic significance in respect of the digital activity. The assessment of a position of strategic significance will consider the undertaking's size or scale in respect of the digital activity, the number of other undertakings using the digital activity, whether the undertaking's position in respect of the digital activity would allow it to extend its market power to a range of other activities and/or the extent to which the undertaking's position allows it to determine or substantially influence the ways in which other undertakings conduct themselves.

The CMA may only designate an undertaking as having SMS after an investigation. Such investigations may take up to nine months (or twelve, if there are "special reasons") and are subject to various consultation and transparency requirements. SMS designations must be reviewed by the CMA at least once every five years.

### **An enforceable Code of Conduct for SMS firms**

The DMU will enforce a code of conduct, consisting of high-level objectives and principles that specify the behaviour expected of businesses with respect to their SMS-designated activity. The objectives include meeting standards of fair-dealing, open choices and trust and transparency. Connected to these objectives, the DMU will have powers to impose on firms conduct requirements to treat users fairly and interact with them on reasonable terms, allow them to choose freely and easily between services and digital content, and provide information needed to make informed choices. Such conduct requirements could also include obligations not to discriminate, self-preference, bundle, leverage, impose use restrictions, use data unfairly, restrict the use of third party products, or restrict interoperability with third-party offerings. For example, in the context of using Apple iPhones to make contactless payments, the CMA previously stated in its Ecosystems Market Study that "specific conduct requirements to provide more equitable third-party access to functionality such as the NFC could include requiring SMS firms not to unreasonably restrict interoperability between the operating system and third-party native apps".

The Bill will give the DMU the power to issue code orders and interim code orders to address breaches of these imposed conduct requirements, following an investigation by the DMU. Firms will be able to assert that a countervailing benefits exemption applies to their conduct, if they can demonstrate that it

gives rise to benefits to users of the digital activity which outweigh any competitive harms, the conduct is indispensable and proportionate to the realisation of those benefits, and the conduct does not eliminate or prevent effective competition.

## Potential for wide-ranging pro-competitive interventions

The DMU will have powers to impose a wide range of PCIs where it considers that a factor or combination of factors relating to a relevant digital activity is having an adverse effect on competition, and where the PCI would be likely to mitigate or prevent that adverse effect. These PCIs will be similar to the remedies available to the CMA under the market investigation regime.

The DMU will be able to trial, review, modify and terminate remedies (including voluntary, enforceable undertakings) and to direct firms with SMS to take specific actions to comply with a PCI order. It will be able to implement PCIs anywhere within an SMS firm, including outside the designated activity, provided the concern relates to the designated activity.

PCIs can be imposed following PCI investigations, which also have a period of 9-12 months (with a further four months within which any PCI order must be issued) and are subject to consultation and transparency requirements.

## Role for financial regulators

The CMA is required to consult financial regulators when exercising certain digital markets functions, including the opening of an SMS investigation, SMS designation, the imposition of a conduct requirement and the making of a PCI. The CMA must consult:

- The FCA regarding a proposal to exercise a regulatory digital markets function where it concerns the provision of financial services and the provision of claims management services;
- The BoE regarding a proposal to exercise a regulatory digital markets function where the CMA considers it would have a material adverse impact on the BoE's ability to advance its financial stability objective;
- The PRA regarding a proposal to exercise a regulatory digital markets function where the CMA considers it would have a material adverse impact on the PRA's ability to advance its general objective and insurance objective.

However, the requirement for the CMA to consult these financial regulators only applies to the extent that the CMA considers that this would not impose a burden on itself that outweighs the benefits of consultation.

The FCA is also able to make a recommendation to the CMA for it to exercise a regulatory digital markets function. For example, this could be used in cases where the FCA identifies a potential competition concern specifically in digital markets for which the CMA is considered to have the most suitable powers to take action.

## Consequences of a breach

As is the case for antitrust infringements, breaches of the code and failures to comply with PCI orders can result in fines of up to 10% of group worldwide turnover, third party "follow on" claims for damages and the disqualification of directors that have been involved in a breach, and the CMA will be able to accept commitments from SMS undertakings to address its concerns. The Bill

also contains a novel "final order mechanism" that may be used by the CMA to set the terms of trade between a SMS and one or more third parties, where it considers that an SMS' existing terms are not fair and reasonable.

## Appeals limited to judicial review standard

Appeals against decisions under the new regime will be to the Competition Appeal Tribunal and the Bill provides for a judicial review standard of appeal, aimed at ensuring that "appropriate deference is given to the DMU's position as an expert regulator". This is the case even for decisions imposing substantial penalties, which under other regimes (including the competition and consumer law regimes) are subject to the more stringent "on the merits" standard of review, in order to satisfy the requirements of the European Convention on Human Rights (**ECHR**), in particular the right to a fair trial. For appeals against penalties under the digital markets regime, the Government is instead relying on the courts to apply the judicial review standard flexibly, with a view to ensuring that the ECHR requirements are met. It remains to be seen whether the resulting degree of scrutiny of penalty decisions will broadly equate to that of a "merits" review. Even if it is, the courts will not have the same options to substitute their judgment for that of the DMU in the event of an adverse ruling, or to vary the amount of any penalty, and will instead be limited to remitting the matter back to the DMU for reconsideration.

The proposed standard of review is out of step with the comparable digital markets regimes of the EU and Germany, which both provide for a greater degree of judicial scrutiny.

## Revised merger review framework for SMS firms

The Bill introduces a requirement on SMS firms to report certain mergers to the CMA before they take place (see box on previous page "*the new merger filing requirements for SMS firms*"). Firms must wait five working days after the CMA accepts the notification as sufficient before completing the merger. The CMA will then decide whether to investigate the merger under the regular UK merger control regime under the Enterprise Act 2002.

In 2022, Apple acquired UK-based FinTech start-up Credit Kudos. If similar FinTech acquisitions were made by SMS firms under the new regime then a filing could be required. The CMA has closely scrutinised FinTech M&A deals in recent years, with FinTech M&A deals representing almost 20% of Phase 2 outcomes from 1 April 2018 – 31 March 2021.

## REFORMS TO THE COMPETITION REGIME

### New and revised merger control thresholds

Filing will continue to be voluntary under the UK merger control regime, so allowing parties to assess and allocate the risk that the CMA decides to investigate their merger and impose remedies. However, revised jurisdictional thresholds will apply to reduce the burden on small businesses as well as to empower the CMA to review mergers that may harm competition even if they do not involve current, direct competitors (see box on next page). In particular, the CMA will have jurisdiction to investigate any merger involving a business with a UK turnover in excess of £350 million and a UK share of supply of 33% or more, provided another party (usually the target) has some sales or activities in the UK, no matter how small. This is likely to mean that for some financial services firms, the CMA will have jurisdiction to review all acquisitions with a UK nexus.

### The new merger filing requirements for SMS firms

Filing will be mandatory if:

- The SMS firm acquires shares or voting rights in a target that causes its total shares or voting rights to exceed a threshold of 15%, 25% or 50% and the consideration paid for that total interest exceeds £25 million; and
- The target carries on activities in the UK or supplies to UK customers.

For transactions involving the creation of a joint venture vehicle that will have activities or sales in the UK, filing will be required if:

- the transaction results in the SMS firm having more than 15% of the shares or voting rights in the joint venture; and
- the total value of all capital and assets contributed to the JV by the SMS firm and consideration for the transaction paid by the SMS firm exceeds £25 million.

The Bill will also introduce certain changes with a view to making merger reviews more efficient, including:

- enabling parties to request a "fast track" reference to Phase 2 review without the requirement for the CMA to assess whether the merger could result in a substantial lessening of competition. Where it accepts such a request, the CMA will be able to extend the Phase 2 process by an additional 3 weeks; and
- providing new possibilities for notifying parties to agree with the CMA to stop the clock in Phase 2, e.g., to allow for early consideration of remedies or to align timing with merger reviews in other jurisdictions.

### Stronger CMA powers in market inquiries

The financial services sector has been subjected to extensive review by the CMA using its market investigation powers, including in the retail banking market investigation and the investment consultants market investigation.

A number of changes will be made to strengthen the CMA's powers and increase flexibility in the markets regime. In particular, the Bill will:

- allow the CMA to narrow the scope of Phase 2 market investigations by reference to particular features of a market;
- provide the CMA with the power to accept binding commitments at any stage in the process to fully or partly address any identified competition concerns; and
- reform the CMA's toolbox of remedies, including the power to require businesses to participate in trials to test its consumer-facing remedies; and to modify any imposed remedies that it considers are not operating effectively. The latter power will only be exercisable after two years from the date when remedies were imposed and before ten years have passed.

### Antitrust investigations and litigation: wider jurisdiction, powers of investigation and exemplary damages

The Bill will expand the territorial scope of the UK competition regime to include agreements and conduct which have, or are likely to have, direct, substantial, and foreseeable effects within the UK, even if not "implemented" in the UK (similar to EU and US antitrust rules).

It will also:

- lower the standard of review for appeals against CMA decisions to impose interim measures;
- allow the CMA to interview third parties with no connection to those under investigation and to compel the disclosure of documents that are not on dawn-raided premises but are accessible from those premises;
- create legal duties for businesses to preserve documents that may be relevant to a CMA antitrust investigation that they know or suspect is, or is likely to be, carried out;
- empower the CMA to address binding information requests to businesses outside the UK that have a sufficient UK connection, which includes carrying on business in the UK through oversight of a subsidiary (addressing a recent court defeat that the CMA suffered on this point);

#### The new merger thresholds

- The target must have UK turnover of more than £100 million (*increased from £70 million*); or
- The creation or enhancement of at least a 25% share of the supply of particular goods or services in the UK, or a substantial part of the UK (*no change*); or
- Any party to the merger (including the acquirer) has at least a 33% share of supply, and UK turnover of more than £350 million, provided at least one other party to the merger has a UK nexus, i.e. it is a UK business or body, carries on activities in the UK or has sales to UK customers (*new threshold*).
- However, irrespective of the above thresholds, no CMA jurisdiction if the worldwide turnover of each of the merging entities is less than £10m (*new safe harbour for small mergers*).

- enter into written agreements for assistance by offenders in a criminal investigation that may be taken into account by courts in sentencing, or specify evidence that the CMA will not use against the offender; and
- enable UK courts to award exemplary damages (*i.e.*, punitive damages, in excess of a claimant's proven losses) in respect of particularly egregious antitrust infringements. This will not apply to collective claims.

### **Higher fines for procedural infringements and non-compliance with remedies**

The Bill will significantly increase the civil fines that can be imposed on businesses for failures to comply with its information gathering powers in merger, markets and antitrust investigations. The maximum fixed fine will increase from £30,000 to 1% of annual worldwide group turnover, and daily fines for ongoing non-compliance will increase from £15,000 to 5% of daily group worldwide turnover. The CMA will also have new powers to impose fines of up to 5% of annual worldwide turnover for breaches of commitments given in antitrust cases, or breaches of remedies imposed in market investigations. At present it must go to court to enforce such obligations.

### **REFORMS TO CONSUMER LAW ENFORCEMENT**

The Bill will strengthen the enforcement of consumers' rights, in particular by enhancing the CMA's (and other sector regulators') civil consumer enforcement powers to match its competition powers. This includes powers of the CMA to issue decisions, make directions requiring removal of infringing online content, impose measures to improve consumer law compliance, impose fines for infringements of up to 10% of group total worldwide turnover (1% of such turnover for procedural infringements), and require payment of compensation or redress to affected consumers. At present, the CMA has to seek a court order to enforce consumer protection laws, so these new powers to enforce directly (without a court order) may lead to much more active enforcement by the CMA.

The reforms to the consumer law enforcement regime may have less of an impact on firms in the financial services sector, as the FCA already has extensive consumer protection powers in the financial sector, including the ability to enforce certain rules without going to court. The FCA's consumer duty will come into force on 31 July 2023. The new Consumer Duty requires that a firm must act to deliver good outcomes for retail customers. In line with the FCA's competition objective, the new rules aim to ensure that firms compete in a fairer and more consumer-focused space, with competition acting more effectively in the interests of consumers where firms design products and services to meet customers' needs. However, the FCA has stated that the value assessment performed by firms under the duty will be a different assessment to the one carried out in the context of competition law on excessive pricing as abuse of a dominant position.

### **COMMENT**

The legislation will create a lot of new work for the CMA, with an entirely new suite of powers to regulate digital markets and wider powers in a range of areas.

While the Government has opted not to extend the concurrency framework to the new digital markets regime, the FCA and other financial regulators will

have an important role in shaping how the DMU's powers are applied to the financial sector.

The FCA is also expected to gain a new statutory objective to facilitate the international competitiveness of the UK economy, including in particular the financial services sector. This may lead the FCA to pay greater attention to other digital markets regimes, such as the EU's Digital Markets Act (**DMA**).

The Government has trumpeted the "flexible and principles-based" approach of its digital markets regime as superior to the "blanket set of obligations" imposed by the DMA which, in the Government's view "risks creating unnecessary regulatory burdens for firms". Whether that proves to be the case will depend on the obligations that the DMU decides to impose on the firms that it designates as having SMS, and – to the extent that those obligations are less stringent than those applicable under the DMA – whether it is cost effective for the regulated businesses to tailor their business models to the UK's regulatory regime.

While the competition law changes are less far-reaching, some may have significant impacts for certain businesses. In particular, the possibility for the CMA to tinker with market investigation remedies for up to 10 years after they are imposed could make such remedies even more intrusive in the future.

The Bill is currently proceeding through the Parliamentary legislative process and is unlikely to enter into force before the second half of 2024, meaning that the first SMS designations are likely to happen in 2025.

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