

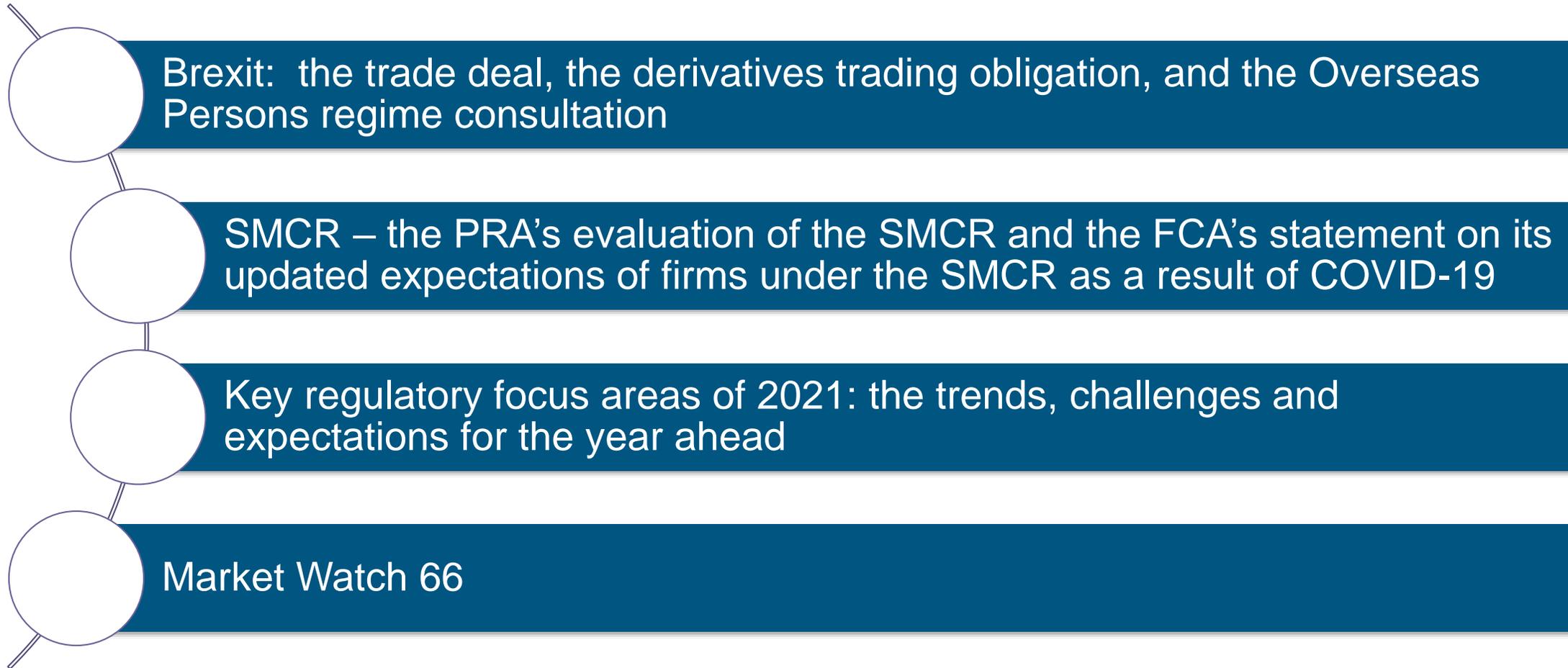


LATHAM & WATKINS

13 January 2021

# Financial Regulation Monthly Breakfast Webcast

# Overview





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Brexit: the trade deal, the derivatives trading obligation, and the Overseas Persons regime consultation

Anne Mainwaring and Rob Moulton

# UK-EU Trade and Cooperation Agreement

- Brexit “deal” agreed on 24 December 2020
- Sets out the future relationship between the UK and the EU
- What does this mean for financial services?
  - Position is largely as expected and as firms had been planning for
  - Effectively a “hard” Brexit scenario for financial services as passporting rights fall away

# What does it say about financial services?

- **International standards:** best endeavours agreement to ensure that internationally agreed standards in the financial services sector for regulation and supervision, for the fight against money laundering and terrorist financing and for the fight against tax evasion and avoidance, are implemented and applied
- **Supply of financial services:** requirement for each party to permit a financial service supplier of the other party established in its territory to supply any new financial service that it would permit its own financial service suppliers to supply in accordance with its law in like situations (but note carve out for branches)

# What does it say about financial services?

- **Prudential carve-out:** neither party is prevented from adopting or maintaining measures for prudential reasons, provided this isn't a means of avoiding other commitments or obligations under the agreement
- **Clearing and payment systems:** access to payment and clearing systems operated by public entities for firms based in the jurisdiction of the other party
- **Self-regulatory organisations:** UK and EU self-regulatory organisations (including exchanges and clearing houses) must admit financial services suppliers of the other party on a non-discriminatory basis

# Personal data

- An interim provision for transmission of personal data means the transmission of personal data from the EU to the UK will not be considered as transfer to a third country
- In place for four months or until an adequacy decision is adopted

# What isn't covered?

- Carve outs for financial services are included in relation to:
  - Most favoured nation clauses
  - Review of non-conforming measures with a view to agreeing possible improvements in the parties mutual interest
  - Agreements relating to licensing requirements and procedures, qualification requirements and procedures, formalities and technical standards that affect cross-border trade in services

# Joint declaration on financial services regulatory cooperation

- Non-binding
- Agreement to establish structured regulatory cooperation on financial services, with the aim of establishing a durable and stable relationship between autonomous jurisdictions
- These arrangements will allow for:
  - Bilateral exchanges of views and analysis relating to regulatory initiatives and other issues of interest
  - Transparency and appropriate dialogue in the process of adoption, suspension and withdrawal of equivalence decisions
  - Enhanced cooperation and coordination including in international bodies as appropriate

# Joint declaration on financial services regulatory cooperation

- Intention is to agree, by March 2021, a Memorandum of Understanding establishing the framework for this cooperation
- *“The Parties will discuss how to move forward on both sides with equivalence determinations between the Union and United Kingdom, without prejudice to the unilateral and autonomous decision-making process of each side”*

# HM Treasury Overseas Framework: call for evidence

- Covers:
  - The Overseas Persons regime, including the Overseas Person Exclusion
  - Equivalence under MiFIR
  - The Recognised Overseas Investment Exchange regime
  - The Financial Promotions Order (for overseas firms)

# Current workings of those regimes

- Section 19 of FSMA turns on “whether or not an activity is regarded as being carried on in the UK” which can “depend on many factors, set out in section 418 of FSMA and PERG 2.4” (paragraph 2.6 of the consultation)
- UK’s approach to characteristic performance (without including a marketing test)
- Overseas person exclusion is limited, and only relevant if an activity might be “in” the UK
- Outcome tends to be that firms which establish themselves in the UK are regulated here (no matter where their clients or markets may be), but firms who do business into the UK do not need to be regulated here – a highly liberal approach compared to most of the EU

# Equivalence

- Original MiFIR approach was to prevent third countries doing any business into the EU unless reverse solicitation applied
  - Fierce objections from HM Treasury (seen as an attack on the City and the Overseas Persons regime )
- Final draft included what we now read as equivalence
  - Something of a trade off
  - UK got to retain its Overseas Persons regime, France confident equivalence as a political decision would not be granted
  - Treated as something of a backwater prior to Brexit
- Important to note that where equivalence is granted, after a three year grace period, any other means of access (such as the Overseas Persons regime) cannot be used

# Recognised Overseas Investment Exchanges

- Additional regime for exchanges
- Some UK supervisory control and visibility, but helpful enablement of participations in UK infrastructure
- 22 overseas exchanges currently have ROIE status
- Consultation recognises that ROIEs “may be able to rely on the OPE rather than the ROIE”

# Financial Promotion Order

- Section 21 Financial Promotion regime applies in addition to Section 19 FSMA licensing regime
- Only authorised persons can make, or approve, promotions which are not exempt
- Helpful list of exemptions:
  - Investment professionals
  - Communications relating to deposit taking
  - High net worth companies *etc.*

# Next steps

- Call for evidence closes 11 March 2021
- Relevance in the context of Brexit
- Long term relevance for the City

# FCA statement on the derivatives trading obligation

- Despite the trade deal, without mutual equivalence, firms will be caught by a conflict of law between the EU and UK DTOs
- The FCA is therefore using its Temporary Transitional Power to modify the application of the UK DTO
- Where firms that are subject to the UK DTO trade with, or on behalf of, EU clients that are subject to the EU DTO, they will be able to transact or execute those trades on EU venues providing that:
  - They take reasonable steps to be satisfied the client does not have arrangements in place to execute the trade on a trading venue to which both the UK and EU have granted equivalence
  - The EU venue has the necessary regulatory status to do business in the UK

# FCA statement on the derivatives trading obligation (continued)

- This relief under the TTP does not apply to trades with non-EU clients, proprietary trading conducted, for example, to hedge a firm's own risk exposure, and trades between UK branches of EU firms - these trades remain subject to the UK DTO
- The FCA will consider by 31 March 2021 whether market or regulatory developments warrant a review of their approach



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SMCR – the PRA’s evaluation of the SMCR and the FCA’s statement on its updated expectations of firms under the SMCR as a result of COVID-19

David Berman

# PRA's evaluation of the Senior Managers and Certification Regime

- On 16 December 2020, the PRA published a report evaluating the SMCR
- The evaluation reviewed the SMCR against its original objectives and examined whether there have been any unintended consequences
- The evaluation covered the period from 2019-2020
- The report is directed at PRA-regulated firms, although various of the findings will also be relevant to FCA solo-regulated firms
  - Consultation with FCA on certain issues
- The report was largely positive
- No need for major changes – however:
  - Some areas that could benefit from amendment
  - Some areas where it is not yet clear whether the SMCR is working as fully intended

# PRA's evaluation of the Senior Managers and Certification Regime – key themes

- The PRA identified three key “themes” and three follow-up actions and recommendations for each of the themes:
  - Holding individuals to account through the SMCR
  - Myth busting and clarifying expectations
  - Application of the SMCR to different business models

# PRA's evaluation of the Senior Managers and Certification Regime – theme 1

## Theme 1: Holding individuals to account through the SMCR

- Key findings:
  - New fitness and propriety requirements are supporting higher professional standards. Alongside these, supervisors are using the regime to clarify responsibility for new business risks and to hold senior individuals to account
  - Most senior managers (94%) who participated in the survey observed that the SMCR had brought about positive changes to behaviours, and nearly all firms reported integrating to some extent the SMCR with internal practices
  - The initial nervousness that accompanied the introduction of the SMCR has reduced as practitioners have become familiar with it
  - Executive pay is being adjusted in response to adverse events and new PRA rules on remuneration, although the additive effect of the SMCR is unclear. Conduct notifications are being used to a limited extent only

# PRA's evaluation of the Senior Managers and Certification Regime – theme 1 (continued)

## Theme 1: Holding individuals to account through the SMCR

- Recommendations:
  1. **Conduct and regulatory references:** Examine the scope for clarifying expectations related to misconduct reporting in notifications and regulatory references, and engage with industry so that regulatory references are used in an appropriate manner
  2. **Remuneration:** Seek feedback on the benefits of further articulating the link between the SMCR and remuneration adjustments: while this is mentioned in speeches, it could be stated more clearly in policy documents
  3. **Senior manager expectations:** Underline the responsibility of those holding Prescribed Responsibilities for the SMR and the Certification Regime to embed these

# PRA's evaluation of the Senior Managers and Certification Regime – theme 2

## Theme 2: Myth busting and clarifying expectations

- Key findings:
  - Concerns have been expressed that risk aversion might prompt some firms to appoint senior managers with similar profiles to existing executives. It is important to affirm the PRA's commitment to ensure the SMCR does not impede steps by firms to improve diversity of skills, experience and backgrounds among their senior management, and to dispel any misconception that the Senior Managers Regime (SMR) favours simple “replication”
  - Most stakeholders saw individual accountability and board responsibility as complementary, and the PRA should continue to promote these in ways that are mutually reinforcing

# PRA's evaluation of the Senior Managers and Certification Regime – theme 2 (continued)

## Theme 2: Myth busting and clarifying expectations

- Recommendations:
  1. **Diversity:** Reaffirm the PRA's appetite for diverse skills and experience among senior management teams through policy and expectations, and/or communications, and examine options for improving data collection and analysis of diversity among the senior management population
  2. **Collective accountability:** Seek further views on whether board responsibilities and individual accountability are mutually reinforcing.
  3. **Interim appointments:** The PRA and FCA are consulting on clarifying regulatory expectations in cases where a senior manager takes temporary leave for longer than 12 weeks

# PRA's evaluation of the Senior Managers and Certification Regime – theme 3

## Theme 3: Application of the SMCR to different business models

- Key findings:
  - The SMCR has been successfully implemented across different business models. Most respondents believed that the regime is proportionate, although medium-sized and smaller firms held this view less strongly
  - There are a number of areas where it would be timely to obtain further views from stakeholders on the flexible application of the regime and on the need for further guidance
  - Approving senior managers on a time-limited and conditional basis has been used much less than envisaged, and options to support the more flexible use of these tools should be examined

# PRA's evaluation of the Senior Managers and Certification Regime – theme 3 (continued)

## Theme 3: Application of the SMCR to different business models

- Recommendations:
  1. **Allocation of responsibilities:** Seek further views on:
    - The usage of the Head of Key Business Area (SMF6) designation at insurers to see why this is used less than at banks
    - The way in which the designation of certain individuals as Key Function Holders works alongside the SMCR
    - The case for further guidance in allocating Prescribed Responsibilities
    - An option for smaller firms to submit SMCR documentation less frequently
  2. **Time-limited and conditional approvals:** Explore options for making time-limited and conditional approvals more readily used in the appointment of senior managers
  3. **New senior manager expectations:** The PRA should consider adding an inventory of guidance and expectations in respect of senior manager responsibility for new and emerging risks to the individual accountability section of the Bank of England website. Supervisors should seek to work with the existing set of senior manager policy expectations wherever possible, to limit their growth

# FCA statement on its updated expectations of firms under the SMCR as a result of COVID-19

- The FCA's expectation is that firms' application of the SMCR rules returns to normal
- Firms should be aware that some of the previously available provisions ended on 7 January 2021
- The relevant modifications by consent will end after 30 April 2021

# Senior Management responsibilities

- As before, the FCA does not require firms to have a single Senior Manager responsible for their COVID-19 response
- Senior Managers are responsible for risks in their areas of responsibility and should consider:
  - Where the current situation might lead to emerging risks
  - How it affects existing risks, along with the controls used to manage them

# Statements of Responsibilities and “significant changes” to Senior Manager Responsibilities

- The temporary provision that the FCA would not expect a firm that needed to make temporary arrangements in direct response to COVID-19 to submit updated Statements of Responsibilities (SoRs), if certain conditions were met, ended on 7 January 2021
- As most firms have now adapted to the new ways of working, the FCA now expects firms to apply the notification requirements as normal and submit a Form J when significant changes are made to SoRs
- The FCA does not now expect firms to submit updated Statements of Responsibilities relating to changes made before 7 January 2021

# Temporary arrangements for Senior Management Functions

- Previously, if temporary arrangements made as a result of COVID-19 lasted longer than 12 weeks, firms could notify the FCA that they consented to an extension of the 12-week rule
- The modification by consent is still available but a firm cannot consent to the modification after 30 April 2021 and all modifications consented to before then will come to an end on that date
- The end date means that the maximum period of extension available to firms reduces closer to 30 April 2021 (*i.e.* the modification will not assist with a temporary appointment that begins after 5 February 2021)
- The FCA expects firms that consent to the modification to clearly document these responsibilities, however temporary
- Under the modification, firms can allocate the Prescribed Responsibilities of the absent Senior Manager to the individual who is standing in

# Furloughed staff

- Little change to previous statement
- Unless a furloughed Senior Manager is permanently leaving their post, the manager will retain their approval during their absence and will not need to be re-approved by the FCA when they return
- The firm is still responsible for ensuring the Senior Manager is fit and proper
- If a firm is subject to the Overall Responsibility rule in SYSC 26, the responsibilities of the furloughed Senior Manager must be allocated to another Senior Manager
- If the firm is relying on the 12-week rule, the replacement does not need not be a Senior Manager
- Individuals performing required functions – *e.g.* Compliance Oversight and the MLRO – should only be furloughed as a last resort



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Market Watch 66  
David Berman

# Market Watch 66

- *“Risks from misconduct may be heightened or increased by homeworking. This includes increased use of unmonitored and/or encrypted communication applications (apps) such as WhatsApp for sharing potentially sensitive information connected with work. Use of such apps can present challenges and significant compliance risks, since firms will be less able to effectively monitor communications using these channels”*
- Firms must **proactively review their recording policies and procedures** every time the context and environment they operate in changes. *“We expect firms to have a **rigorous monitoring regime, commensurate to the increased risks, where in-scope activities may be conducted outside the controlled office environment.** As part of this, individual Senior Managers have an important part to play in establishing and embedding the right culture and governance within firms to continuously improve the standard of conduct at all levels”*

# Market Watch 66

- Policies and procedures should be adopted for home working arrangements
  - Must identify which telephone conversations and electronic communications are subject to recording requirements
  - Must also contain procedures to follow where breaches or gaps have been identified

# Market Watch 66

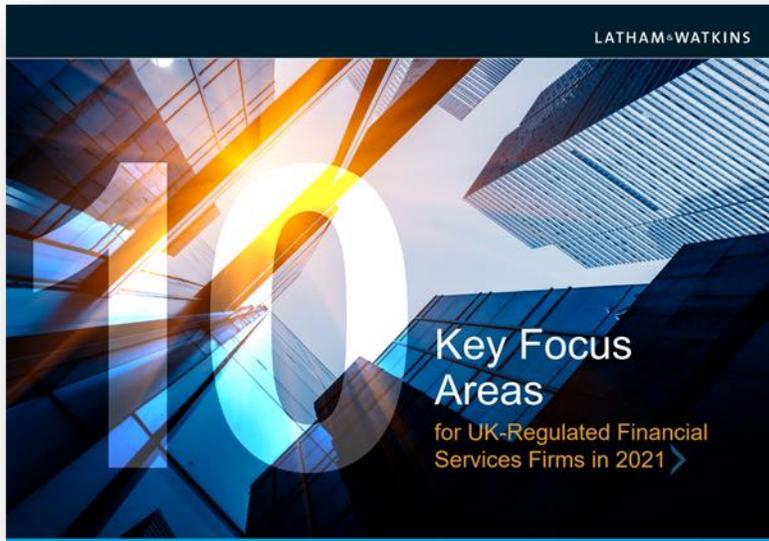
- *“Firms should assess policies and controls for the use of privately owned devices to connect to their organisational networks and access work-related systems and potentially sensitive or confidential data, to ensure that these provide sufficient scope for effective recording. This might include ensuring clear policies banning the use of privately owned devices for in-scope activities where recording cannot be carried out by the firm. In all cases, arrangements should be clear that new communication mediums must be approved by the firms before being used by employees to conduct business activities”*
- Enhanced or refreshed training to cover use of new technologies and conduct risks arising



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Key regulatory focus areas of 2021: the trends,  
challenges and expectations for the year ahead  
Nicola Higgs

# 2021: A look to the year ahead



- 1 • Brexit
- 2 • MiFID II Refit
- 3 • MAR
- 4 • Conduct & Culture
- 5 • Senior Manager Enforcement
- 6 • ESG
- 7 • Prudential Reform
- 8 • Data
- 9 • Antitrust
- 10 • Biden

# 2021: What to look out for

	Key dates	Points to note
MiFID II Refit	TBD (2021)	<ol style="list-style-type: none"> <li>1. MiFID II Refit           <ul style="list-style-type: none"> <li>• Costs &amp; charges:               <ul style="list-style-type: none"> <li>• Professional clients will no longer receive information on costs and charges. They will however still receive information on investment advice and portfolio management.</li> <li>• Ex-post information on costs and charges should be supplied without delay and clients should be able to receive this information over the phone (or on paper if requested). Also, the client should be given a breakdown of the costs before concluding a transaction.</li> </ul> </li> <li>• Sustainability:               <ul style="list-style-type: none"> <li>• Retail clients will be able to receive information in digital format instead of on paper, but should be given at least eight weeks' notice and the choice to continue receiving information on paper or switch to a digital format.</li> </ul> </li> <li>• Product governance:               <ul style="list-style-type: none"> <li>• Product governance requirements will no longer apply to corporate bonds with no other embedded derivative than a make whole clause or where the financial instruments are marketed or distributed exclusively to eligible counterparties.</li> </ul> </li> <li>• Investment research:               <ul style="list-style-type: none"> <li>• Measures to address decline in SME research.</li> </ul> </li> <li>• Commodity derivatives:               <ul style="list-style-type: none"> <li>• Some changes to the position limits regime for commodity derivatives, including a new definition for agricultural commodity derivatives to clarify that these derivatives include fisheries as well as animal feed. For those agricultural commodities the current strict regime will still apply, while less sensitive commodity contracts will be subject to a lighter regime.</li> </ul> </li> </ul> </li> <li>2. Will the UK follow suit?</li> </ol>

# 2021: What to look out for

	Key dates	Points to note
MAR	Commission considering ESMA Final Report	<ol style="list-style-type: none"><li>ESMA MAR review<ul style="list-style-type: none"><li>Pre-hedging / front running: ESMA proposes developing detailed guidance on acceptable practice, but identifies a number of factors such as trade by trade transparency that may be disruptive to some existing practices.</li><li>Market soundings: ESMA has maintained its stance that the market soundings regime is compulsory, and is unmoved by arguments driven by conflicts of laws and extraterritorial effect.</li><li>Insider lists: ESMA has provided some flexibility on the question of who should be included on an insider list, and how large a permanent insider list should be, without changing the thrust of its overall position that deal lists should capture only those who have accessed inside information.</li></ul></li><li>FCA COVID-19 focus<ul style="list-style-type: none"><li>Inside information in 2020 (distressed companies), under less closely controlled (home working) conditions.</li></ul></li></ol>

# 2021: What to look out for

	Key dates	Points to note
ESG	<p>10 March 2021: SFDR applies</p> <p>Q1 2020: 'UK SFDR' to be consulted on</p>	<ol style="list-style-type: none"> <li>1. "UK SFDR" consultation expected in Q1: <ul style="list-style-type: none"> <li>• Alignment with Level 1 SFDR?</li> <li>• Alignment with scope of SFDR?</li> </ul> </li> <li>2. SFDR <ul style="list-style-type: none"> <li>• Significant implementation challenges for firms in scope</li> <li>• What buy-side pressure will the sell-side experience as a result of SFDR implementation</li> </ul> </li> <li>3. EU Taxonomy <ul style="list-style-type: none"> <li>• Disclose proportion of an institutions activities that are linked to sustainable activities</li> </ul> </li> <li>4. UK mandatory TCFD disclosures</li> </ol>
Prudential Reform	<p>EU IFD and IFR enter into effect on 26 June 2021</p> <p>14 Dec 2020: FCA first consultation on UK IFPR. Two further consultations planned for 2021</p>	<ol style="list-style-type: none"> <li>1. IFD / IFR – adaptation of existing bank led prudential regime for the investment market: <ul style="list-style-type: none"> <li>• Capital requirements</li> <li>• Governance</li> <li>• Remuneration</li> </ul> <p>FCA: "... supports the aims of the IFD/IFR. The FCA proposes that the IFPR will achieve the same overall outcomes. The FCA believes that this is consistent with its statutory objectives and Mission. However, as it is introducing the regime after the UK has exited the EU, it believes it is right to also consider what amendments are appropriate to account for the specifics of the UK market, and its duties to have regard to certain factors, including those set out in the Government's recently introduced Financial Services Bill."</p> </li> </ol>

# 2021: What to look out for

	Key dates	Points to note
Data	2021+	<ol style="list-style-type: none"><li>1. FCA consultation on the extent to which the pricing of data is, or is not, in line with its expectations under the various “reasonable commercial bases” tests in regimes such as MiFID</li><li>2. FCA call for input on the use of data under MAR – responses due January 2021</li></ol>
Antitrust	2021+	<ol style="list-style-type: none"><li>1. Combination of FCA intervention and follow on risks of damages claims: the recent Supreme Court decision (making it more likely that a class action based redress approach will develop in the UK)</li></ol>
Biden	2021+	<ol style="list-style-type: none"><li>1. CFTC policy agenda</li><li>2. New SEC Chair – more aggressive enforcement stance</li><li>3. US commitment to Paris-alignment and repositioning on international alignment of ESG initiatives</li></ol>

# Connected with Latham Podcasts

## Brexit & Financial Services: Preparing for the End of the Transition Period

With the end of the Brexit transition period looming, many financial services firms are asking what they need to do between now and the end of the year to ensure regulatory compliance.

In this episode of *Connected With Latham*, Anne Mainwaring, London associate in the Financial Regulatory Practice, joins Stephen Hanks, Manager in the Markets Policy Department at the UK's Financial Conduct Authority, to discuss key focus areas in the run up to, as well as beyond, the end of the transition period. Focus topics include the approach to onshoring, the key MiFID II onshoring changes, and the FCA's approach to implementation review and policy following the end of the transition period.

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## Corporate Culture: How to Attain Sustainable Change

Culture has become a point of focus for regulators and corporate stakeholders. The UK Financial Conduct Authority has taken a particular interest in culture and conduct within the financial services sector following the financial crisis. Companies increasingly recognise a need to measure and monitor their culture, yet struggle to do so given its amorphous nature.

In this episode of *Connected With Latham*, London partner Rob Moulton speaks with the authors of "Culture — A Practical Framework for Sustainable Change", London partner David Berman and associate Nell Perks, as well as Nathan Seltzer, Global Vice Chair of the firm's White Collar Defense & Investigations Practice. The team examines how organisations are getting a handle on measuring culture, monitoring for progress, and uncovering problem areas requiring action. They also discuss various culture issues arising from the COVID-19 pandemic and what companies can anticipate as their workforces shift to a hybrid model of working remotely and in the office.

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The podcast cover features a dark purple background with a white waveform graphic. In the top left corner, there is a red square with the text 'Connected with LATHAM' and a small logo. The title 'Brexit & Financial Services: Preparing for the End of the Transition Period' is written in white at the top right. Below the title, there are two circular headshots: one of Stephen Hanks on the left and one of Anne Mainwaring on the right. To the right of Stephen Hanks' headshot is his name and title: 'Stephen Hanks, Manager, Markets Policy Department, Financial Conduct Authority'. To the right of Anne Mainwaring's headshot is her name and title: 'Anne Mainwaring, Associate, London'.

The podcast cover features a dark purple background with a white waveform graphic. In the top left corner, there is a red square with the text 'Connected with LATHAM' and a small logo. The title 'Corporate Culture: How to Attain Sustainable Change' is written in white at the top right. Below the title, there are four circular headshots arranged in a 2x2 grid. To the right of the top-left headshot is the name and title: 'David Berman, Partner, London'. To the right of the top-right headshot is the name and title: 'Nell Perks, Associate, London'. To the right of the bottom-left headshot is the name and title: 'Nathan Seltzer, Partner, London'. To the right of the bottom-right headshot is the name and title: 'Rob Moulton, Partner, London'.

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LATHAM & WATKINS LLP



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