



LATHAM & WATKINS

10 June 2020

Financial Regulation Monthly Breakfast Webinar

Overview



Brexit: the Financial Services Chapter of the UK Government's Draft Free Trade Agreement

The FCA's Market Watch 63 on market conduct; and its updated statement on half yearly financial reports

Observations on the FCA's interventions in the Russell Adams case (on unregulated introducers, and the duty of care owed to clients)

Financial Services exemptions in the Corporate Insolvency and Governance Bill

IOSCO's Principles on Outsourcing consultation report, and ESMA's cloud outsourcing consultation paper



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Brexit: the Financial Services Chapter of the UK
Government's Draft Free Trade Agreement
Anne Mainwaring

UK Government Draft UK-EU Free Trade Agreement

- On 19 May 2020, the UK government published its proposal for an outline of a UK-EU Free Trade Agreement (FTA) as a draft negotiating document, including a specific financial services chapter
- This is the first time that the UK government has set out in detail its expectations for financial services in the UK's future relationship with the EU

UK Government Draft UK-EU Free Trade Agreement

- UK sets out an ambitious approach to maintain full single market access as far as possible:
 - Continued provision of cross-border financial services
 - No less favourable treatment for financial services and cross-border financial service suppliers than the most favourable treatment given by that government to its own like financial services and financial service suppliers
 - No limitations or restrictions to market access for UK or EU financial service suppliers located in the relevant territory

The EU approach

- Starting point is third country treatment
- Limited market access commitments
- EU will continue to apply its host state-rules to incoming providers
- The UK draft FTA was also accompanied by a letter addressed to Michel Barnier which looked at some of the issues in relation to the negotiations:
 - *“In services, the EU is resisting the inclusion of provisions on regulatory cooperation for financial services, though it agreed them in the EU-Japan EPA. The EU’s offer on lengths of stay for short-term business visitors (Mode 4) is less generous than CETA, and does not include the non-discrimination commitment found in EU-Mexico. The EU has also not proposed anything on services which reflects the specific nature of our relationship: indeed your team has told us that the EU’s market access offer on services might be less than that tabled with Australia and New Zealand”*

Brexit watch points

- Significant Brexit milestones coming up:
 - “Stocktake” on progress of negotiations
 - Deadline for the extension of the transition period

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The FCA's Market Watch 63 on market conduct; and
its updated statement on half yearly financial reports
David Berman

Market Watch 63 - context

- Market Watch 63 published on 27 May 2020
- Sets out the FCA's expectations of market conduct in the context of:
 - Increased capital raising events
 - Alternative working arrangements
 - The additional challenges created by the COVID-19 pandemic

Market Watch 63 - focus

- FCA encourages particular focus on:
 - Appropriately identifying and handling inside information so that it is not misused for insider dealing or for commercial advantage
 - Ensuring inside information is appropriately disclosed by listed companies so investors are not misled
 - Maintaining robust market surveillance and suspicious transaction reporting by relevant market participants
 - Meeting requirements under the Short Selling Regulation
 - Identifying and managing conflicts of interest by market participants in relation to capital raising events

Market Watch 63 - treatment of inside information

- Controls must continue to effectively protect against unlawful disclosure in working from home environments in the same manner as in the office
- Repeat or update training to refresh staff on how they should be handling inside information
- Ensure those with access to inside information are on insider lists and that they understand their legal and regulatory duties
- Be alert to the possibility of leaks and rumours in light of changed working arrangements
- Prepare holding announcements to be used if there is an actual or likely breach

Market Watch 63 - wall-crossing

- Inside information disclosed as part of wall-crossings should be strictly controlled
- Disclosing participants must maintain appropriate records
- Recipients should only communicate information received internally to those persons that are fulfilling a specific duty

Market Watch 63 - short selling

- Obligations under the Short Selling Regulation must be met, in particular in relation to the restrictions on uncovered short sales in shares and net short position reporting

Market Watch 63 - managing conflicts in capital raisings

- Dear CEO Letter on 28 April 2020: reports of banks failing to treat corporate customers fairly when negotiating debt facilities
- FCA will take action against banks in breach of the FCA's rules or Principles

Market Watch 63 - market conduct during credit events

- Use of credit default swaps: FCA, SEC, and CFTC have previously set out shared concerns about “opportunistic strategies”
- FCA expects market participants to comply with their obligations under MAR

Primary Market Bulletin 28 - additional relief for publication of half-yearly results

- Additional temporary relief for listed companies during the COVID-19 crisis
- Issuers have an additional month to file half-yearly financial reports (i.e. four months from the end of the half-year period)
- Q&A also published
- FCA's approach is consistent with ESMA's guidance
- Temporary relief which will continue for the duration of the pandemic

Primary Market Bulletin 28 - going concern assessments

- FCA understands the difficulties issuers face due to COVID-19 where an auditor's going concern assessment gives rise to a need to include remarks in their audit opinion
- FCA encourages investors and lenders to take into account the unique set of circumstances that might result in uncertainty in issuers' financial positions when assessing their responses to such disclosures

Primary Market Bulletin 28 - shareholder engagement

- FCA encourages issuers to engage with shareholders through disclosures to the market about the implications of COVID-19 on their business
- When making alternative arrangements to physical general meetings, issuers should look for ways to allow shareholders to ask questions of management, i.e. through virtual meetings
- Issuers with large numbers of smaller shareholders are recommended to consider when conducting placings if there are routes that may be available to make participation in a capital raising available to those shareholders
- FCA recognises this may not be feasible due to time pressures on issuers or legal risks



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Observations on the FCA's interventions in the
Russell Adams case (on unregulated introducers,
and the duty of care owed to clients)

Rob Moulton

Background

- Mr Adams decided to invest in a real estate opportunity (storage facilities) having discussed it with an unauthorised intermediary
- Mr Adams was introduced by the unauthorised intermediary to OSUK, who provided execution-only SIPP administration services
- The investment lost money and Mr Adams brought several claims against OSUK

Claims

- The entire SIPP arrangement was unenforceable because the unregulated introducer had, in a way known by OSUK, contravened Section 19 and Section 27 FSMA (i.e. it had been an arrangement)
- OSUK had breached COBS 2.1.1 (the client's best interest rule) by allowing the risky investment to be put into the SIPP
- OSUK were liable for the negligent advice on the investment provided by the unregulated introducer as they were in a joint venture

Facts

- Mr Adams knew that the investment was high risk
- Mr Adams was aware that OSUK were not providing him with advice
- Mr Adams knew what the limitations of OSUK's role were, even if he did not understand the meaning of the phrase "execution-only"
- *“Question – do you really think that a 48 year old lorry driver was in a position to make a decision as important as this about how much of his transferred money should be used to buy store pods, or weren't you interested? Answer – I don't think that it is my nor my company's position to assume that a 48 year old lorry driver could or couldn't do it. We are a SIPP administration company accepting execution-only business”*

FCA's interventions

- The unregulated introducer had made unlawful (and therefore regulated) arrangements by operating a business that generally referred clients to a particular SIPP administrator. The definition of an arrangement is a “but for” test, and Mr Adams would not have made the investment but for the introduction to the SIPP administrator
- COBS 2.1.1 cannot be limited by a contract that limits the services being provided, as firms cannot exclude duties that they owe to clients under the regulatory system. FCA gave as an example “*a duty not to accept into a SIPP an investment of a kind that is inappropriate...SIPP investment by a retail customer who is not known to have received independent regulated advice about the investment*”

Judgement

- The claim was dismissed on the basis that:
 - The introducer had not been making regulated arrangements which require an important contribution
 - The duty owed under COBS 2.1.1 was a duty to act fairly taking into account the service being provided (“the regulatory regime does not take precedence over the contract”)
- The tort claim failed because it requires assistance in the commission of the tort by the defendant, when in practice their services had been entirely separate
- Note Judge’s comments on usefulness of Thematic Reviews in court (“*not an aid to statutory construction*” where FSA had previously stated that SIPP providers were not taking “basic measures” like checking whether introducers were regulated)

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Financial Services exemptions in the Corporate
Insolvency and Governance Bill
Rob Moulton

Corporate Insolvency and Governance Bill 2020

- The Corporate Insolvency and Governance Bill 2020 was introduced to the House of Commons on 20 May 2020
- Consists of a number of new insolvency and corporate governance measures to help businesses affected by the COVID-19 pandemic
- Certain measures do not apply to some financial services firms
- Excluded financial services firms include banks, investment firms, insurers, payments and e-money institutions, certain market infrastructure bodies and securitisation companies

Financial services exemptions

- Company Moratorium
 - New stand-alone moratorium – period of 20 business days (+ 20 business days extension)
 - No legal action can be taken or continued against a company without leave of the court
 - Exclusion for certain financial services firms and contracts
- Suspension of Ipso Facto (Termination) clauses
 - Prohibition of supplier termination clauses
 - Exclusion for certain financial services firms and contracts

Financial services exemptions

- Suspension of Wrongful Trading Provisions
 - Temporary suspension of wrongful trading provisions for four months
 - Retrospective effect from 1 March 2020 to 30 June 2020
 - Will not apply to the directors of financial services firms, in order to protect client assets

Changes where no exemptions for financial services

- New Restructuring Plan
 - New cross-class cram down restructuring plan procedure
 - Available to financial services firms, but with appropriate safeguards including a role for the FCA and the PRA
- No exemptions for the remaining provisions, including the:
 - Temporary suspension of Statutory Demands and Winding up Petitions
 - Temporary flexibility of AGMs
 - Temporary flexibility of Filing Requirements
- The Bill will now go to the House of Lords for consideration and implementation is expected late June 2020



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IOSCO's Principles on Outsourcing consultation
report, and ESMA's cloud outsourcing consultation
paper

Becky Critchley

Principles for Outsourcing - background

- Consultation report published by IOSCO on “Principles for Outsourcing” on 28 May 2020
- Report prepared before COVID-19 outbreak
- COVID-19 has highlighted need to ensure resilience in operational activities and to maintain business continuity in unforeseen circumstances
- Revised “Principles on Outsourcing” based on:
 - IOSCO’s 2005 “Principles on Outsourcing of Financial Services for Market Intermediaries”
 - IOSCO’s 2009 “Principles on Outsourcing by Markets”

Principles for Outsourcing – application and fundamental precepts

- Application of proposed principles expanded to include:
 - Trading venues
 - Market participants acting on a proprietary basis
 - Credit rating agencies
 - Financial market infrastructures
- A set of fundamental precepts and seven principles
- The fundamental precepts cover issues such as:
 - The definition of outsourcing
 - The assessment of materiality and criticality
 - Their application to affiliates
 - The treatment of sub-contracting and outsourcing on a cross-border basis
 - Concentration

Principles for Outsourcing – seven principles

- The seven principles cover:
 1. Due diligence in the selection and monitoring of a service provider
 2. The contract with a service provider
 3. Information security, business resilience, continuity and disaster recovery
 4. Confidentiality issues
 5. Concentration of outsourcing arrangements
 6. Access to data, premises, personnel and associated rights of inspection.
 7. Termination of outsourcing arrangements
- Revised principles supplemented with guidance for implementation
- Deadline for comments: 1 October 2020

ESMA's consultation paper on guidelines on outsourcing to cloud service providers

- Consultation paper published by ESMA on 3 June 2020
- Consultation closes on 1 September 2020
- ESMA to consider responses in Q3 2020
- ESMA final report and guidelines expected in Q4 2020 / Q1 2021
- *“Financial markets participants should be careful that they do not become overly reliant on their cloud services providers... They need to closely monitor the performance and the security measures of their cloud service provider and make sure that they are able to exit the cloud outsourcing arrangement as and when necessary... [the] proposals will help firms understand and mitigate the risks that they are exposed to when outsourcing to cloud service providers”*

ESMA's consultation paper on guidelines on outsourcing to cloud service providers

- Provides guidance on the outsourcing requirements applicable to firms where they outsource to cloud service providers
- Consistent with, although largely less detailed than:
 - The recommendations on outsourcing to cloud service providers published by the EBA in February 2017 and revised EBA guidelines on outsourcing arrangements published in February 2019
 - The guidelines on cloud outsourcing published by EIOPA in February 2020

ESMA's consultation paper on guidelines on outsourcing to cloud service providers

- Nine draft guidelines address:
 - Governance, oversight and documentation
 - Pre-outsourcing analysis and due diligence
 - Minimum elements for outsourcing and sub-outsourcing agreements
 - Information security
 - Exit strategies
 - Access and audit rights
 - Sub-outsourcing
 - Written notification requirements to competent authorities
 - Supervision of cloud outsourcing arrangements by competent authorities

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