

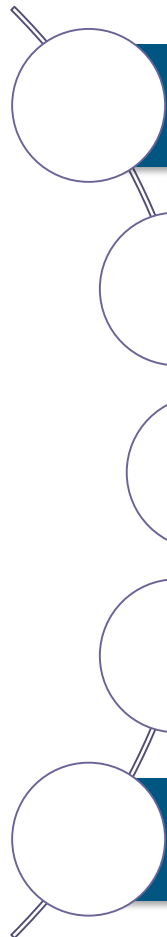


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13 March 2019

# Financial Regulation Monthly Breakfast Seminar

# Overview

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- 1 The latest on MiFID II
  - 2 EBA Outsourcing Guidelines
  - 3 PRIIPs update
  - 4 EU Benchmarks Regulation
  - 5 The latest on Brexit

A blue-tinted background featuring a financial line chart with a grid. The chart shows two data series: a solid line and a dotted line. The solid line starts high on the left, dips, rises, dips again, and then rises sharply towards the right. The dotted line starts high, dips, and then trends downwards. The overall aesthetic is professional and data-oriented.

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The latest on MiFID II  
Carl Fernandes

- A “pause for breath” year, after intense implementation in 2016 and 2017
- Elements of the transparency regime still evolved; best execution reporting started; some further guidance on algorithmic trading
- Some supervisory attention and commentary on:
  - Transaction Reporting
  - Research unbundling / inducements generally
  - Costs and charges

# 2019 so far

- In January 2019 Andrew Bailey before the Treasury Committee of the HoC said in response to a question about how well firms have adapted to MiFID II:

“We have three things going on here. The first piece of work, which we have done, is on costs and charges. That is probably the most relevant one, in a sense, to the discussions that have been had in public. Then we will do work this year on new product governance and research unbundling, where there has also been an issue as to how that works. All that work is a product of our supervisory work as to how effective the application of MiFID II has been”
- He also confirmed that there was no enforcement action in train, and that all work was supervisory



# Research unbundling

- 25 February 2019, Andrew Bailey gave the keynote speech at the European Independent Research Providers Association. He referred to a multi-firm review of buy and sell side since summer 2018 – more formal feedback in Q2
- Key takeaways:
- **Pros:**
  - Continue to strongly support unbundling and related reforms
  - Large number of asset managers have chosen to fund from own pocket (which is a shift from expectations in 2016/17)
  - 20-30% reduction in overall research costs (£180m in reduced costs to investors)

# Research unbundling (cont.)

- **Challenges/concerns**

- Supervisory flexibility for independent providers given the absence of inducement element
- Price discovery continuing to evolve, and some concern about extreme low cost models. Must be informed by value – qualitative and quantitative
- Impact on SME coverage?

# Costs and charges

- Lots of concerns during the implementation phase, particularly in wholesale markets as to how to apply the requirements in various contexts, including derivatives trading:
  - What amounts to a cost/charge
  - When do you have an “ongoing relationship” for ex-post annual aggregated disclosure
- Even in retail markets, access to relevant inputs and inconsistency in presentation of information was a known challenge
- On 25 February, FCA published findings of supervisory work looking at ex-ante costs – looked at 50 firms in retail sector (both product providers and distributors)



# Costs and charges – findings from FCA review

- All firms were aware of the rules, and had given serious consideration to implementation
- Good practices included training of staff; voluntary extension of standards beyond scope of rules; use of technology to give clients interactive information
- Areas for improvement:
  - Proper disclosure of transactions costs embedded in products; or estimating at zero
  - Making clearer to customers that they can request further breakdowns
  - Headlining low costs in marketing material, with higher costs disclosed in product Documents; or against out of date industry averages
  - Failure to include cash equivalents in addition to percentages
  - Interactions with UCITS and PRIIPs
- A promise to follow up and consider “whether further action is required”



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EBA Outsourcing Guidelines  
Fiona Maclean

# Overview

- On 25 February 2019, the EBA published its final report on the EBA outsourcing guidelines. The guidelines:
  - **Replace** the 2006 guidelines on outsourcing by the Committee of European Banking Supervisors (CEBS)
  - **Incorporate** the EBA's Final Recommendations on Outsourcing to Cloud Service Providers
  - **Apply** to all financial institutions within the scope of the EBA's mandate (credit institutions, investment firms subject to the Capital Requirements Directive, payment institutions and electronic money institutions), i.e. a wider range of entities than CEBS's 2006 guidelines
  - **Come into effect** on 30 September 2019 (save for third country banking / payment services for which the Guidelines come into effect on 31 December 2021)
  - **Grace period** until 31 December 2021

# Meaning of 'Outsourcing'

- **Meaning of 'outsourcing'**
  - Based on the MiFID II definition and will therefore be familiar to financial institutions
  - The use of a pre-existing definition will likely ease the burden of implementing the Guidelines
- **'Critical or Important Functions'**
  - The meaning of critical or important functions is again based on the wording in MiFID II
  - Although stricter rules apply to critical or important functions, the Guidelines provide requirements for all outsourcing of functions unless expressly stated otherwise

# Meaning of 'Outsourcing' (cont.)

- **Third Country Outsourcing**
  - Additional safeguards required for outsourcing or subcontracting to a third country
- **Intra-Group Outsourcing**
  - “...internal governance arrangements, processes and mechanisms...adequate for the effective application of these guidelines at all relevant levels”

# Governance and record keeping

- **Risk Management Framework**
  - Holistic institution-wide risk management framework
  - Identify, assess, monitor and manage all risks
  - No delegation of management responsibilities
- **Outsourcing Policy**
  - Written Policy
  - Main phases of an outsourcing lifecycle of outsourcing arrangements and define principles, responsibilities and processes



# Governance and record keeping (cont.)

- **Register of Outsourcing**
  - Up-to-date register of all outsourcing arrangements
  - Reference number; service provider; nature of outsourcing; whether or not critical, etc.
  - Concentration Risk!
- **Business Continuity Planning**
  - Resilience and ongoing performance planning

# Contracting process

- **A Laundry List of contractual requirements: Same-Same but Different?**
  - Scope
  - SLAs
  - Reporting Obligations
  - Continuity Obligations
- **Data, Data, Data**
  - Location
  - Access, availability, integrity, privacy and security

# Contracting process (cont.)

- **Audit**
  - “Full access to all relevant business premises (e.g. head offices and operation centres)”
  - “..unrestricted rights of inspection and auditing related to the outsourcing arrangement (‘audit rights’)”
- **Termination**
  - Subjective or Objective?
- **Exit Strategy**
  - Lock-In
  - Second Generation Cloud?

# Key takeaways

- Risk Management Documentation must be updated and/or implemented
- Outsourcing DD to be formalised
- Concentration Risks to be considered both intra-group and cross-sector
- Intra-group arrangements to be reviewed
- Data and Cyber Risks remain high priority

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PRIIPs Update  
Rob Moulton

# PRIIPs update

- ESAs consultation in November 2018
  - Acknowledged there was not time to undertake a full review
  - Suggested it would be worthwhile making smaller amendments
  - Proposed targeted amendments to the PRIIPs KID, including amendments to the presentation of performance scenarios
  - Proposed amendments to address the application of the PRIIPs KID to UCITS from 2020
- Subsequently, the European Parliament has adopted amendments to the Regulation, which are expected to be adopted shortly. These:
  - Provide for a review of the Regulation by 31 December 2019
  - Extend the exemption for UCITS until 31 December 2021



# PRIIPs update (cont.)

- ESAs Final Report on amendments to the PRIIPs KID (February 2019)
  - Respondents did not support the proposed targeted amendments – they favoured a more comprehensive review of the PRIIPs framework
  - Respondents felt that the proposed amendments would be of limited benefit and would not address the fundamental issues
  - Some respondents were also concerned that, due to the shortened consultation process, there was not time to fully analyse the proposals and their implications
  - Therefore, the ESAs are not taking the proposed amendments forward, but will instead provide input into the planned review during 2019

# PRIPs update (cont.)

## Supervisory statement on performance scenarios

- PRIP manufacturers should:
  - Include a statement in the KID warning the investor of the limitations of the figures shown
  - Add a new warning stating “Market developments in the future cannot be accurately predicted. The scenarios shown are only an indication of some of the possible outcomes based on recent returns. Actual returns could be lower”
  - In other information provided to the investor, include additional explanations or put the performance scenario figures in the KID in additional context
- Any additions to the KID should be limited to what the manufacturer considers essential to ensure that the presentation of performance scenarios is fair, accurate, clear and not misleading
- Manufacturers should not encourage investors to disregard the information in the KID

# PRIPs update (cont.)

## FCA Feedback Statement on Call for Input

| Issue  | Feedback   | Next steps   |
|--|--|--|
| Scope – uncertainty in particular regarding application to corporate bonds | FCA sees concerns as particularly serious and likely to cause consumer harm if not addressed       | FCA to urge EU institutions to take action, and will consider issuing domestic interpretive guidance |
| Summary Risk Indicators – giving misleading impressions                    |  |  |
| Performance Scenarios – produce misleading illustrations                   |  |  |
| Transaction Costs – KIDs displaying unrepresentative costs                 | Unrepresentative costs result from poor application of the methodology, not the methodology itself | FCA work to increase understanding; could investigate firms if poor practices continue               |

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EU Benchmarks Regulation  
Rob Moulton

# EU Benchmarks Regulation – where are we now?

- 1 January 2018 – Full application of the EU BMR (subject to transitional provisions)
- 29 March 2019 – UK to become a third country under the EU BMR post-Brexit
- 1 January 2020 – original end of EU BMR transitional period; applications for registration / authorisation / recognition / endorsement to be submitted

# EU Benchmarks Regulation – where are we now? (cont.)

- European Parliament and Council have reached political agreement on an **extension of the EU BMR transitional period to 31 December 2021 for critical and third country benchmarks:**
  - “Given the crucial importance of third-country benchmarks for EU companies, the extra two years for benchmarks produced outside the EU was also introduced to provide additional time for work with non-EU regulators on how these benchmarks can be recognised as equivalent or otherwise endorsed for use in the EU.”  
(European Commission Press Release – 25 February 2019)



# EU Benchmarks Regulation – third country issues

- Regulators have not seen enough live applications yet to have worked through many of the difficult issues being raised
- Extension to the transitional provisions is welcome, but does not change the framework and so firms still need to get on with their preparations – they cannot expect more forbearance
- Issues remain concerning the recognition and endorsement routes, particularly the level of oversight than an endorsing EEA administrator would need to provide
- Acknowledgement that there will be a critical mass of third country benchmarks that cannot use one of the three routes for use in the EEA, cannot benefit from an exemption, and for which there is no commercial alternative



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The latest on Brexit  
Anne Mainwaring

# No-deal planning – key publications

- Bank of England Policy Statement/PRA Policy Statement PS5/19 - The Bank of England's amendments to financial services legislation under the European Union (Withdrawal) Act 2018
- FCA Policy Statement PS19/5 – Brexit Policy Statement

# No-deal planning - the UK perspective

| UK firms   | Temporary permission firms   | EU firms without temporary permission  |
|--|--|--|
| <ul style="list-style-type: none"><li>• UK onshored legislation</li><li>• Temporary transitional relief (Bank of England, PRA and FCA) - 15 months</li><li>• Transitional relief is subject to certain exceptions where compliance is required from exit day</li></ul> | <ul style="list-style-type: none"><li>• Starting point: TP firms can generally keep complying with the rules as they do now</li><li>• All UK rules that currently apply plus those currently reserved to the home state</li><li>• Substituted compliance will be permitted in relation to the latter – compliance with equivalent home state rules is sufficient</li></ul> | <ul style="list-style-type: none"><li>• Firms which do not require authorisation to operate in the UK</li><li>• Financial services contracts regime (FSCR) - contractual continuity regime</li><li>• Automatic for EEA firms which passport into the UK which fail to notify to enter the TPR but still have regulated business in the UK to run off</li></ul> |

# UK firms

- FCA Transitional Direction
- Continuity is generally achieved by applying a ‘standstill’ so firms may continue to comply with the pre-exit version of an obligation
- Reiterated in PS19/5:
  - “This means firms and other regulated entities can generally continue to comply with their regulatory obligations as they did before exit day for a temporary period”
- The Annexes to the Transitional Direction confirm the application of the ‘standstill’
- For example, in relation to COBS, firms can continue to:
  - Rely on certain information, recommendations and assessments provided by EEA firms
  - Categorise non-UK local public authorities in accordance with pre-exit opt-up criteria

# Temporary permission firms

- TP substituted compliance direction
- TP firms can comply with obligations included in the TP substituted compliance direction which were, before exit, reserved to the home state of the TP firm by complying with:
  - The same provision of the relevant directly applicable EU measure which applies in their home state; or
  - A provision of their home state law which implements the same provision of the relevant directive
- TPR firms can rely on substituted compliance where their home state has exercised a discretion afforded by an EU directive in a different way to the UK including discretion not to implement at all (provided this is a permitted option)

# FCA statements of policy on operation of UK MiFID transparency regime following no-deal Brexit

- FCA has published its Statements of Policy outlining how it will operate the MiFID transparency regime in a no-deal scenario
- In such a scenario the FCA will be solely responsible for operating the MiFID transparency regime
- UK MiFIR provides the FCA with certain temporary powers to operate the regime flexibly during a 4 year transitional period
- The Statements of Policy outline how the FCA intends to use these powers
- In general the FCA doesn't intend to use its powers to suspend the ordinary operation of the transparency regime but rather will react to market events and/or actions taken by EU or other regulators



# No-deal planning - the EU perspective

- ESMA statement on the impact of Brexit on MiFID II and the Benchmark Regulation
  - C(6) carve-out
    - A derivative contract related to electricity or natural gas that is exclusively produced, traded and delivered in the UK would no longer qualify as a wholesale energy product post-Brexit and would no longer be eligible for the C(6) carve out even if traded on an EU27 OTF
    - A wholesale energy contract not traded on an EU27 OTF post-exit would also no longer be eligible for the carve out
  - Trading obligation for derivatives
    - ESMA does not currently have any evidence that market participants will be unable to continue to comply with the derivatives trading obligation in a no deal scenario in the absence of an equivalence decision for UK trading venues

# No-deal planning - the EU perspective (cont.)

- ESMA statement on the impact of Brexit and MiFID II and the Benchmark Regulation (cont.)
  - Post-trade transparency
    - ESMA's existing position will be maintained for UK trading venues – EU27 firms will not therefore be required to make transactions public in the EU27 via an EU APA that are executed on an EU trading venue
    - EU investment firms will however be required to make public transactions concluded OTC with UK counterparties via an APA established in the EU27
  - BMR
    - In a no-deal scenario UK administrators will be deleted from the ESMA register of administrators and third-country benchmarks
    - During the BMR transitional period this will not have any effect on the ability of EU27 supervised entities to use the benchmarks provided by those UK administrators as during the transitional period EU supervised entities can use third-country benchmarks even if they are not included in the ESMA register

# Investment firm review - equivalence

- “With the investment firm review, the EU gets Brexit-ready” – Markus Ferber
- “We have beefed up the equivalence provisions significantly”
- Amendments to the MiFIR third country equivalence regime:
  - “Where a third-country firm, including through an entity acting on its behalf....solicits clients or potential clients in the Union, it shall not be deemed as a service provided at the own exclusive initiative of the client”
  - Enhanced requirements for equivalence decisions by the Commission
  - Where the services/activities performed by a third-country firm in the EU are likely to be of systemic importance for the Union the prudential, organisational and business conduct requirements of that third country may only be found to have equivalent effect after “a detailed and granular assessment”
  - Move from outcomes based assessment to line by line?



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Questions?