

A blue-toned background image featuring a financial line chart with multiple data series and a grid. The chart shows various trends, including a sharp decline followed by a recovery and another decline.

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12 May 2021

# Financial Regulation Monthly Breakfast Webcast

# Overview



The second FCA consultation on the Investment Firms Prudential Regime

The FCA's proposed changes to the Listing Rules to accommodate SPACs

The FCA's consultation on changes to the UK MiFID rules on research unbundling and best execution

The sustainable finance amendments to MiFID II and AIFMD

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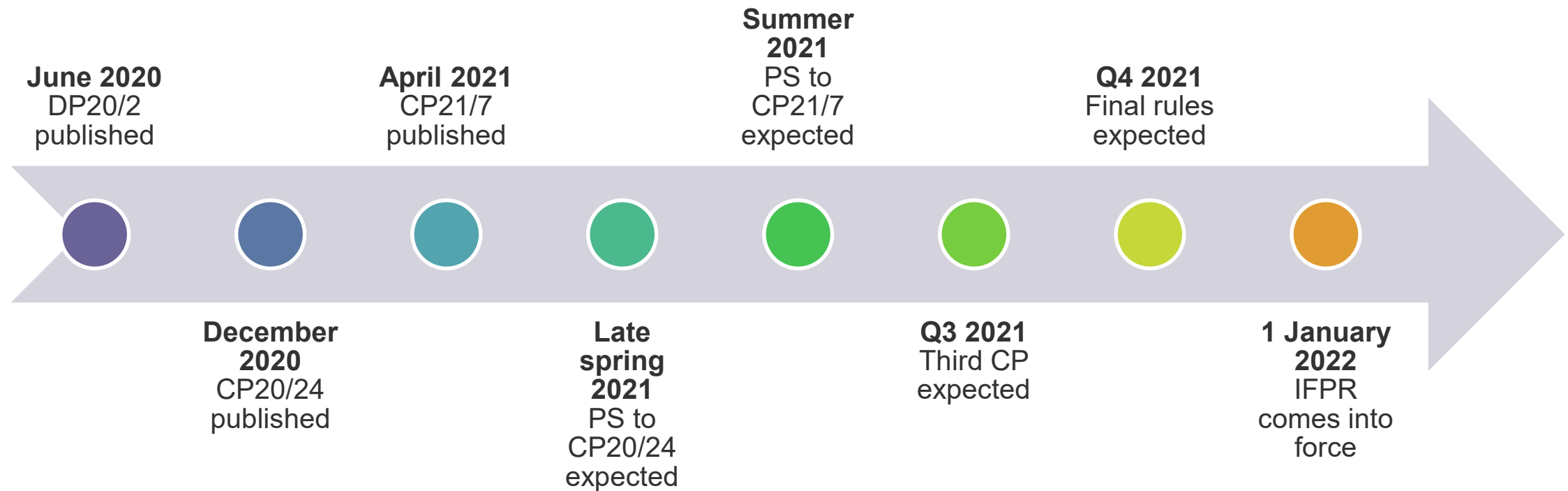
The second FCA consultation on the Investment  
Firms Prudential Regime  
Rob Moulton

# Background

- FCA is consulting on introducing a new UK Investment Firms Prudential Regime, reflecting the EU IFD/R regime
- This is the second of three CPs:
  - First CP (CP20/24) covered categorisation of firms, prudential consolidation, certain own funds requirements, transition
  - Second CP (CP21/7) covers remuneration, risk management and governance, liquidity requirements, further own funds requirements
  - Third CP will pick up residual matters such as disclosures and consequential amendments to the FCA Handbook
- Comments are requested by **28 May 2021**



# Timing



# Recap: Who is caught by the IFPR?

- Any MiFID investment firm authorised and regulated by the FCA that is currently subject to any part of the Capital Requirements Directive and the Capital Requirements Regulation
- Collective Portfolio Management Investment Firms
- Regulated and unregulated holding companies of groups that contain an investment firm in the above categories

# CP21/7: Remuneration

- FCA proposes to make all IFPR firms subject to a single MIFIDPRU Remuneration Code, but the requirements will differ depending on the firm's size
- Firms will be divided into SNIs, smaller non-SNIs, and larger non-SNIs
- A firm will be classed as a larger non-SNI if:
  - (i) the value of its on-and off-balance sheet assets over the preceding four-year period is a rolling average of more than £300 million; or
  - (ii) the value of its on-and off-balance sheet assets over the preceding four-year period is a rolling average of more than £100 million (but less than £300 million), and it has trading book business of over £150 million, and/or derivatives business of over £100 million

# CP21/7: Remuneration

## Largest non-SNI firms

- Must comply with “extended” remuneration requirements (e.g. apply rules on deferral and pay-out of variable remuneration for material risk takers, establish a remuneration committee)

## Non-SNI firms

- Must comply with “standard” remuneration requirements (e.g. identify material risk takers, set appropriate ratios between fixed and variable remuneration, apply requirements on performance assessment and risk adjustment, and apply rules on the use of guaranteed variable remuneration, retention awards, buy-out awards, and severance pay for material risk takers)

## All firms

- Must comply with basic remuneration requirements (e.g. have a clearly documented remuneration policy, ensure that fixed and variable remuneration elements of all staff are appropriately balanced)



# CP21/7: Remuneration

- FCA plans to include an exemption from the rules on deferral and pay-out when a material risk taker's annual variable remuneration is £167,000 or less and makes up one-third or less of their total remuneration (more generous than the EU rules)
- FCA does not propose to include a bonus cap for any IFPR firms

# CP21/7: Risk Management

- Key expectation will be that firms consider the potential harm they could cause to consumers and markets, as well as risks to their own safety and soundness
- As previously indicated, the FCA plans to introduce an internal capital and risk assessment (ICARA) process for all FCA investment firms – this will be used to determine a firm’s own funds threshold requirement and liquid assets threshold requirement
- ICARA process will consolidate FCA requirements in relation to business model analysis, stress-testing, recovery planning and actions, and wind-down planning
- Senior Managers will be responsible for signing off on ICARA documentation
- FCA plans to use a “harm-led” approach rather than having a minimum Supervisory Review and Evaluation Process cycle for most firms

# CP21/7: Governance

- Largest non-SNI firms will be required to have risk, remuneration, and nomination committees – this will capture more firms than at present

# CP21/7: Own Funds

- FCA is consulting on the K-factors based on assets safeguarded and administered, client money held, assets under management, and client orders handled
- Already consulted on the K-factors that only apply to firms with permission to deal as principal in CP20/24
- FCA is also proposing to introduce a fixed overheads requirement (FOR) that will apply to all firms within the IFPR
- The FOR is intended to calculate a minimum amount of capital that a firm would need available to absorb losses if it has cause to wind-down or exit the market

# CP21/7: Liquidity Requirements

- FCA proposing a basic liquid assets requirement for all IFPR firms
- Firms will need to hold core liquid assets equivalent to at least one third of the amount of their FOR and 1.6% of the total amount of any guarantees provided to clients
- FCA will set out a list of core liquid assets that firms can use to meet the basic liquid assets requirement

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# The FCA's proposed changes to the Listing Rules to accommodate SPACs

Chris Horton



# FCA consultation on proposed changes to the Listing Rules for certain SPACs – Why?

- US and EU SPAC trends
- Lord Hill Review
- FCA announcement on 31 March 2021 (future consultation on strengthening investor protections in SPACs)
- FCA consultation on proposed changes to the Listing Rules for certain SPACs (CP21/10: Investor protection measures for SPACs: Proposed changes to the Listing Rules)

# FCA consultation on proposed changes to the Listing Rules for certain SPACs – What?

- FCA is proposing to remove the presumption of suspension for SPACs that meet certain criteria which are intended to strengthen investor protections whilst maintaining the smooth operation of the market
- The proposed criteria include the following:
  - Meeting a minimum size threshold based on the amount raised when a SPAC's shares are initially listed;
  - Setting a time limit on a SPAC's operating period if no acquisition is completed;
  - Ensuring monies raised from public markets are ring-fenced so that they are preserved to either fund an acquisition or be returned to shareholders (less any amounts specifically agreed to be used for a SPAC's running costs);

# FCA consultation on proposed changes to the Listing Rules for certain SPACs – What?

- The proposed criteria include the following: (cont.)
  - Ensuring shareholder approval for any proposed acquisition, based on sufficient disclosure of key terms and a "fair and reasonable" statement where any conflict of interest exists between SPAC directors and a target company;
  - A "redemption" option allowing investors to exit a SPAC before any acquisition is completed; and
  - Adequate disclosures being provided to investors at the appropriate stages in a SPAC's lifecycle (from a SPAC's initial listing to any final transaction resulting in a SPAC completing a takeover of another business and establishing a new company)
- For SPACs not meeting these conditions, the presumption of suspension would continue to apply

# FCA consultation on proposed changes to the Listing Rules for certain SPACs – When?

- The FCA is consulting for four weeks on the above proposals (with comments due by 28 May 2021) and is aiming to introduce the investor protection measures “by the summer”
- Impact on current SPAC transactions
- Market commentary on the proposals

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The FCA's consultation on changes to the UK MiFID  
rules on research unbundling and best execution

Gabriel Lakeman

# Background – MiFID “quick fix”

- EU MiFID II “quick fix” measures to apply from 28 February 2022
- Changes relating to:
  - Research on small and mid-cap issuers
  - Temporary suspension of RTS 27 reports
  - Costs and charges disclosures
  - Communications with clients
  - New exemptions from product governance requirements
  - Commodity derivatives position limits regime



# CP21/9 - Research

- FCA proposes several new additions to the list of acceptable minor non-monetary benefits
- Means certain types of research could be “rebundled” with execution services
- Keen to stress that it considers the rules on research unbundling to be working well overall and these are targeted amendments only

# CP21/9 - Research

- Proposed exemption for research relating to an SME with a market capitalisation below £200 million (c.f. EU threshold of €1 billion)
- Threshold would be assessed for the 36 calendar months preceding the provision of the research
- FCA considers this will help to address the low levels of research on SMEs

# CP21/9 - Research

Further exemptions proposed for:

- Research received in connection with an investment strategy primarily relating to FICC instruments
- Research provided by independent research providers (not engaged in execution services and not part of a financial services group that includes an investment firm that offers execution or brokerage services)
- Written material that is made openly available from a third party to any firms wishing to receive it, or to the general public (accessible without conditions or barriers such as a log-in, sign up, or submission of user information)

# CP21/9 – Best execution reporting

- FCA proposes to remove the requirements to produce RTS 27 and RTS 28 reports entirely
- FCA found that the reports are not being used (or even viewed) by the intended audience, and market participants typically use other data to evaluate execution services
- Found no version of a report using aggregated data that would be sufficiently useful
- In the meantime, firms can rely on FCA statement that it will not take action against firms that do not produce RTS 27 reports for the rest of 2021

# Next steps

- Comments requested by 23 June 2021, with a Policy Statement expected in the second half of the year
- HM Treasury will need to consult on other changes made by the “quick fix” package, as they require amendments to legislation
- FCA planning two further related consultations on:
  - The consequences of LIBOR transition for the derivatives trading obligation (due before summer 2021)
  - Changes to markets requirements (due autumn 2021)
- Commission due to publish legislative proposal under MiFID Refit by the end of the year
- Future divergence?

The background of the slide is a blue-toned financial line chart. It features a grid of dashed lines and several data series represented by thick, glowing blue lines. The lines show various trends, including a sharp decline on the left, a peak, a dip, and a subsequent rise on the right. The overall aesthetic is professional and data-oriented.

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The sustainable finance amendments to MiFID II  
and AIFMD  
Anne Mainwaring



# European Commission adopts delegated legislation integrating sustainability measures into sectoral legislation

- On 21 April the Commission published six amending Delegated Acts as part of its sustainable finance package
- The purpose of this legislation is to embed sustainability considerations within:
  - MiFID II
  - AIFMD
  - UCITS
  - Solvency II
  - Insurance Distribution Directive
- These changes are designed to reinforce SFDR, the Taxonomy Regulation and the Low Carbon Benchmarks Regulation by integrating sustainability considerations into the investment, advisory and disclosure processes in a consistent manner across sectors

# Amendments to MiFID II

- The amendments to MiFID II are set out across two amending Delegated Acts:
  - Amendments to Delegated Regulation (EU) 2017/565 - integration of sustainability factors into the suitability requirements and the organisational requirements and operating conditions for investment firms
  - Amendments to Delegated Directive (EU) 2017/593 - integration of sustainability factors into the product governance obligations

# Amendments to the MiFID Delegated Regulation

MiFID Delegated Regulation	Amendment
<b>Organisational requirements &amp; risk management</b> <b>Articles 21(1) &amp; 23(1)(a)</b>	Requires investment firms to take into account sustainability risks when complying with the MiFID II organisational requirements and to take into account sustainability risk: <ul style="list-style-type: none"><li>• in their risk management policies;</li><li>• in their procedures which identify the risks relating to the firm's activities, processes and systems; and</li><li>• when setting the level of risk tolerated by the firm.</li></ul>
<b>Conflicts of interest</b> <b>Article 33</b>	When identifying conflicts of interest that may damage the interests of a client, such assessment must include those types of conflicts of interest that stem from the integration of the client's sustainability preferences. For existing clients, where a suitability assessment has already been undertaken, investment firms should have the possibility to identify the client's individual sustainability preferences at the next regular update of the existing suitability assessment.

# Amendments to the MiFID Delegated Regulation

MiFID Delegated Regulation	Amendment
<b>Information about investment advice</b> <b>Article 52(3)</b>	Investment firms providing investment advice must, when disclosing the factors taken into consideration in the selection process, include any sustainability factors taken into consideration.
<b>Assessment of suitability and suitability reports</b> <b>Articles 54(2), (5), (9), (10), (12) and (13)</b>	<p>Investment firms providing financial advice or portfolio management services should carry out a mandatory assessment of sustainability preferences of their clients. These investment firms should take these sustainability preferences into account in the selection process of the financial products that are offered to these clients.</p> <p>Adequate policies and procedures must ensure that firms understand the nature and features of investment services and financial instruments selected for their clients, including any sustainability factors.</p> <p>An investment firm shall not recommend financial instruments or decide to trade such instruments as meeting a client's or potential client's sustainability preferences when those financial instruments do not do meet those preferences.</p> <p>Suitability reports must explain how the recommendation meets the client's sustainability preferences.</p>

# Amendments to the MiFID Delegated Directive

MiFID Delegated Directive	Amendment
<p><b>Manufacturer requirements</b></p> <p><b>Articles 9(9), (11), (13) and (14)</b></p>	<p><i>Target market:</i> specify the type(s) of client with whose needs, characteristics and objectives, including any sustainability related objectives, the financial instrument is compatible. The sustainability factors of the financial instrument shall be presented in a transparent manner and provide distributors with the relevant information to duly consider any sustainability related objectives of the client or potential client.</p> <p><i>Negative target market:</i> not required where financial instruments consider sustainability factors.</p> <p><i>Review:</i> consider if the financial instrument remains consistent with any sustainability preferences of the target market.</p>

# Amendments to the MiFID Delegated Directive

MiFID Delegated Directive	Amendment
<b>Distributor requirements</b> <b>Articles 10(2) and (5)</b>	<p><i>Target market:</i> have in place adequate product governance arrangements to ensure that products and services offered or recommended are compatible with the needs, characteristics, and objectives, including any sustainability related objectives, of an identified target market and that the intended distribution strategy is consistent with the identified target market.</p> <p><i>Negative target market:</i> investment firms shall identify any group of clients with whose needs, characteristics and objectives the product or service is not compatible except where financial instruments consider sustainability factors.</p> <p><i>Review:</i> assess at least whether the product or service remains consistent with the needs, characteristics and objectives, including any sustainability related objectives, of the identified target market and whether the intended distribution strategy remains appropriate.</p>

# Amendments to the AIFMD Delegated Regulation

<b>AIFMD Delegated Regulation</b>	<b>Amendment</b>
<b>Due diligence requirements</b>  <b>Article 18</b>	<p>Sustainability risks must be taken into account as part of the due diligence requirements in relation to the selection and monitoring of investments.</p> <p>Where an AIFM considers principal adverse impacts of investment decisions on sustainability factors under SFRD it must take into account such principal adverse impacts when complying with the due diligence requirements.</p>
<b>Resources</b>  <b>Article 22</b>	<p>AIFMs shall retain the necessary resources and expertise for the effective integration of sustainability risks.</p>
<b>Conflicts of interest</b>  <b>Article 30</b>	<p>AIFMs shall ensure that when identifying the types of conflicts of interest, the existence of which may damage the interests of an AIF, they shall include those types of conflicts of interest that may arise as a result of the integration of sustainability risks in their processes, systems and internal controls.</p>
<b>Risk management policy</b>  <b>Article 40</b>	<p>The risk management policy shall comprise such procedures as are necessary to enable the AIFM to assess for each AIF it manages the exposure of that AIF to market, liquidity, sustainability and counterparty risks, and the exposure of the AIF to all other relevant risks, including operational risks, which may be material for each AIF it manages.</p>



# Amendments to the AIFMD Delegated Regulation

AIFMD Delegated Regulation	Amendment
<p data-bbox="86 422 563 515"><b>General organisational requirements</b></p> <p data-bbox="86 558 341 596"><b>Article 57(1)</b></p>	<p data-bbox="619 422 2418 515">AIFMs shall take into account sustainability risks when complying with the following requirements:</p> <ul data-bbox="619 558 2418 1142" style="list-style-type: none"><li data-bbox="619 558 2418 651">a) decision-making procedures and organisational structure which specifies reporting lines and allocates functions and responsibilities clearly and in a documented manner;</li><li data-bbox="619 694 2418 786">b) ensuring that their relevant persons are aware of the procedures to be followed for the proper discharge of their responsibilities;</li><li data-bbox="619 829 2418 922">c) internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the AIFM;</li><li data-bbox="619 965 2418 1058">d) effective internal reporting and communication of information at all relevant levels of the AIFM and effective information flows with any third party involved; and</li><li data-bbox="619 1100 2418 1142">e) adequate and orderly records of their business and internal organisation.</li></ul>

# Amendments to the AIFMD Delegated Regulation

AIFMD Delegated Regulation	Amendment
<p><b>Control by the governing body, senior management and supervisory function</b></p> <p><b>Article 60(2)</b></p>	<p>Senior management of the AIFM is responsible for the integration of sustainability risks in relation to:</p> <ul style="list-style-type: none"><li>a) each AIF's investment policy and, where relevant, in the fund rules, the instruments of incorporation, the prospectus or the offering documents;</li><li>b) the investment strategies for each managed AIF;</li><li>c) the valuation policies and procedures;</li><li>d) the compliance function;</li><li>e) ensuring the general investment policy, the investment strategies and the risk limits of each managed AIF are properly and effectively implemented and complied with;</li><li>f) the adequacy of the internal procedures for undertaking investment decisions for each managed AIF, so as to ensure that such decisions are consistent with the approved investment strategies;</li><li>g) the risk management policy and the arrangements, processes and techniques for implementing that policy, including the risk limit system for each AIF it manages; and</li><li>h) the remuneration policy.</li></ul>

# Timing

- MiFID organisational and AIFMD changes
  - Delegated Regulations
  - Will apply 12 months after publication in the OJ
- MiFID product governance changes
  - Delegated Directive
  - The Delegated Directive will enter into force 20 days after its publication in the OJ
  - Member states will need to adopt the Delegated Directive and measures will apply 15 months after entry into force

# UK approach

- TBC ...

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