

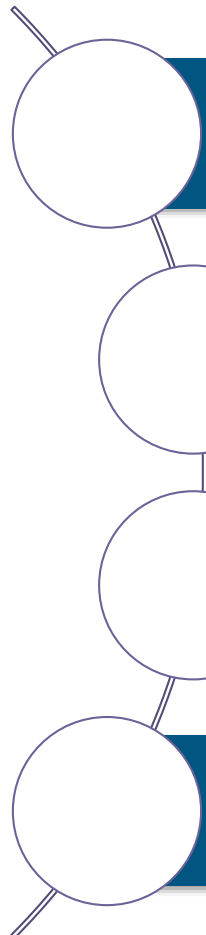


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11 November 2020

Financial Regulation Monthly Breakfast Webcast

Overview

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- 1. Brexit, including the latest updates on the share trading obligation, post-trade transparency and short selling
 - 2. AIFMD, and the proposed changes to the passporting regime
 - 3. Recent FCA enforcement action, including on short selling and non-financial misconduct
 - 4. ESMA's consultation paper on market data under MiFID



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Brexit, including the latest updates on the share trading obligation, post-trade transparency and short selling

Anne Mainwaring

ESMA sets out final position on the share trading obligation

- ESMA has published a statement that clarifies the application of the EU share trading obligation following the end of the transition period
- After the end of the transition period:
 - All EU shares (ISINs starting with a country code corresponding to an EU Member State) and shares with an ISIN from Iceland, Liechtenstein and Norway (EEA ISINs) will be within the scope of the EU share trading obligation
 - GB ISINs will be outside the scope of the EU share trading obligation
 - Shares with an EEA ISIN that trade on a UK trading venue in GBP will be outside the scope of the EU share trading obligation

ESMA sets out final position on the share trading obligation

- ESMA notes that shares with an EEA ISIN traded on UK trading venues in GBP are limited in number (less than 50) and account for a small proportion of the EU total trading activity (less than 1%)
- ESMA concludes that it can therefore be reasonably assumed that the trading of shares with an EEA ISIN on a UK trading venue in GBP by EU investment firms occurs on a **non-systematic, ad-hoc, irregular and infrequent basis**
- ESMA specifies that it has done the maximum possible to minimise disruption and to avoid overlapping share trading obligations and their potentially adverse effects for market participants, but notes that the approach that it has put forward will only effectively avoid such overlaps if the UK adopts an approach that does not include EEA ISINs under the UK share trading obligation

ESMA sets out final position on the share trading obligation

- Note that ESMA's statement is only meant to address the specific circumstances of trading of EEA ISIN shares on UK trading venues in GBP - the application of the share trading obligation to shares with a different ISIN should continue to be determined taking into account the previous ESMA guidance

FCA sets out its approach to the share trading obligation

- The FCA notes that only mutual equivalence would mean that firms could continue to satisfy share trading obligations at trading venues in both the EEA and the UK
- Accordingly, in the absence of mutual equivalence, the FCA will instead use its Temporary Transitional Powers to avoid disruption and allow firms to continue trading all shares on EU trading venues and systematic internalisers
- This means that UK market participants will continue to be able to access any EU trading venue from the end of the transition period, providing the venue has ensured it has the relevant UK regulatory permissions

FCA sets out its approach to the share trading obligation

- The FCA's approach is stated to preserve the ability of UK-based firms to execute their share trades at the venues where they can get the best execution for themselves and their customers and avoids the need to change rules to require new order-routing restrictions to be introduced
 - *“At the end of the transition period, the UK's and EU's regimes will be the most equivalent in the world, but as it stands this has not been recognised by the EU. While we note ESMA's recent clarifications to reduce the potential overlap of an EU and UK STO, we chose this simple and comprehensive approach rather than to replicate restrictions based on the jurisdiction of the share issuer, or the currency in which a share is issued”*

Post-trade transparency and position limits

- ESMA has added UK venues to its opinions on third country trading venues related to the MiFIR transparency and position limits provisions
- This means that from 1 January 2021:
 - EU investment firms will not be required to make transactions public in the EU via an EU APA if they are executed on one of the UK trading venues of the transparency list
 - Commodity derivative contracts traded on UK trading venues on the position limits list will not be considered as economically equivalent over-the-counter contracts for the EU position limit regime

FCA information about Brexit from EEA regulators

- The FCA has published an information page linking to dedicated Brexit websites hosted by financial regulators in EEA member states
- <https://www.fca.org.uk/brexit/information-eea-regulators>
- The FCA highlights that firms may want to check with the relevant EEA regulators whether the authorities in that jurisdiction are planning any transitional measures and/or discuss the implications of any of the schemes that may be available

HM Treasury consults on post-EU financial services regulatory framework

- HM Treasury has published a consultation paper marking the start of Phase II of its financial services review, which will focus on the broader regulatory framework for financial services regulation in the UK post-Brexit
- The government believes that the FSMA model of regulation, which delegates the setting of regulatory standards to expert, independent regulators that work within an overall policy framework set by government and Parliament, continues to be the most effective way of delivering a stable, fair and prosperous financial services sector

HM Treasury consults on post-EU financial services regulatory framework

- However, the EU approach to regulation, which is largely being preserved through the onshoring exercise, involves detailed regulatory standards being set in legislation applying across Member States in order to facilitate a single market in financial services, therefore moving the UK's regulatory framework away from the model based on delegation of standard setting to regulators
- The government sees the UK's departure from the EU as an important opportunity to review the UK framework arrangements to ensure the overall approach to regulation of financial services is right for the UK – the government believes this would be best achieved by building on the strengths of the FSMA model as it was originally intended to operate

HM Treasury consults on post-EU financial services regulatory framework

- The consultation will remain open for three months, closing on 19 January 2021
- The government will use the feedback to inform a second consultation in 2021, which will set out a final package of proposals

The UK grants a package of equivalence decisions to the EU and EEA member states

- *“We are starting a new chapter in the history of financial services and renewing the UK’s position as the world’s pre-eminent financial centre. By taking as many equivalence decisions as we can in the absence of clarity from the EU, we’re doing what’s right for the UK and providing firms with certainty and stability. Our plans will ensure the UK moves forward as an open, attractive and well-regulated market, and continues to lead the world in pioneering new technologies and shifting finance towards a net zero future”*
- Rishi Sunak

The UK grants a package of equivalence decisions to the EU and EEA member states

- Equivalence findings are file specific *e.g.*:
 - EMIR: equivalence granted to EEA States for the intragroup exemption
 - CRR: equivalence granted so that UK firms will not be subject to increased capital requirements as a result of their EEA exposures
 - CRA: equivalence means that non-systemic credit rating agencies authorised or registered in the EEA will be able to apply to be certified in the UK, subject to certain regulatory requirements
- These findings do not address the bigger question of the ability of UK firms to access Europe



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AIFMD, and the proposed changes to the
passporting regime
Becky Critchley

European Commission consultation on review of the AIFMD

- The European Commission launched a consultation on the review of the AIFMD on 22 October 2020
- The consultation follows the European Commission's review report sent to the European Parliament and Council on 10 June 2020 and ESMA's letter to the European Commission on 18 August 2020 recommending priority topics in the AIFMD review
- List of questions rather than proposals
- Next steps:
 - Deadline for responses is 29 January 2021
 - European Commission is expected to publish legislative proposal in Q3 2021

European Commission consultation on review of the AIFMD – scope and authorisation

Views are requested on the following topics:

- Scope and authorisation
 - Potential improvements to the AIFMD legal framework to facilitate further integration of the EU AIF market
 - The scope of the AIFM licence and its potential extension to smaller AIFMs
 - What changes are needed to ensure a level playing field between AIFMs and other financial intermediaries like MiFID firms, credit institutions or UCITS managers that provide similar services

European Commission consultation on review of the AIFMD – EU passport

- AIFM passport
 - Improvements to the current passporting regime to enhance the utility of the AIFM passport
 - Level the playing field between AIFMs and other financial intermediaries
 - Extending the passport to sub-threshold AIFMs

European Commission consultation on review of the AIFMD – investor protection

- Investor protection
 - Whether it is possible to enable access to AIFs to a wider pool of retail investors
 - Create an AIF that can be marketed to retail investors with a passport
 - Whether the disclosure requirements are adequate
 - Alleged ambiguities in the depositary regime and the need for a depositary passport
 - Potential improvements to the AIFMD rules on conflicts of interest and valuation

European Commission consultation on review of the AIFMD – international relations and passporting

- International relations and passporting
 - Where to strike the balance of having a functioning, efficient AIF market and ensuring that it operates under the conditions of a fair competition without undermining financial stability
 - How the EU market could interact with international partners in the area governed by the AIFMD
 - The appropriateness of the AIFMD third country passport regime and delegation rules

European Commission consultation on review of the AIFMD – financial stability

- Financial stability
 - Whether the intervention powers available to regulators are sufficient in times of severe market disruptions
 - How to ensure NCAs and AIFMs have the tools necessary to effectively mitigate and deal with systemic risks
 - The potential for more centralised supervisory reporting and improved information sharing among the relevant supervisors
 - A revised supervisory setup and cooperation measures among the competent authorities
 - Suggestions on the optimal harmonisation of the rules that could apply to loan originating AIFs

European Commission consultation on review of the AIFMD – investing in private companies

- Investing in private companies
 - Whether the AIFMD rules on investing in private companies are fit for purpose or could be improved

European Commission consultation on review of the AIFMD – sustainability

- Sustainability/ESG
 - How the alternative investment sector can participate effectively in the areas of responsible investing and the preservation of our planet
 - Should AIFs only quantify sustainability risks disclosures under the SFDR
 - Should investment decision processes of any AIFM integrate the assessment of non-financial materiality, *i.e.* potential principal adverse sustainability impacts
 - Whether AIFMs should be required to take account of sustainability-related impacts beyond what is currently required by EU law (such as environmental pollution and degradation, climate change, social impacts, human rights violations *etc.*)
 - Whether the Taxonomy Regulation or other sustainability-related requirements or international principles should play a role when AIFMs are making investment decisions

European Commission consultation on review of the AIFMD – miscellaneous

- Miscellaneous
 - Should ESMA have additional powers and be entrusted with the authorisation and supervision of all AIFMs
 - Whether the UCITS and AIFM regulatory frameworks should be merged into a single EU rulebook



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Recent FCA enforcement action, including on short
selling and non-financial misconduct
Andrea Monks

Short selling – new enforcement appetite?

- “*Failure to report disclosable short positions undermines the integrity and efficiency of financial markets*”: Mark Steward, Director of Enforcement
- A new perspective, or a case of “if not now, when?”
- The Firm’s final undisclosed net short position was the largest net short position ever held in an issuer admitted to the Official List with shares admitted to trading on the Main Market of the London Stock Exchange
- The Firm did not inform the FCA promptly upon discovering its failure to comply with its SSR obligations
- Fine of £873,118, after a 30% discount for settlement at stage 1

Short selling enforcement – the facts

- Asset management firm based in HK, not typically trading in EU markets
- Between February 2017 and December 2019, the Firm:
 - Failed to make 155 notifications of its net short position to the FCA
 - Failed to make 153 disclosures of its net short position to the public
- By 5 July 2019, net short position equivalent to 16.85% of Premier Oil's issued share capital via equity swaps
- Held for a further 106 days before being notified to the FCA and the public
- Delay between finding the problem and reporting to the FCA
- How?
 - Relied on third party materials about the rules, which omitted derivatives trading
 - Investigated first, reported second

Short selling enforcement – the lessons

- Statements in support of the reasons for SSR in the Final Notice
 - Short selling can contribute to market liquidity and efficient price formation
 - But it can create systemic risks, be abusive or create disorderly markets
 - The purpose of SSR is to improve transparency and support markets operating with integrity
 - It enables the FCA to monitor and identify risks
 - And market participants can make informed investment decisions
- Trading in unfamiliar markets carries risk
 - Reliance on third party regulatory materials
 - Failure to appreciate the speed required for Principle 11 reports

Non-financial misconduct – a reminder

- FCA “Dear CEO” letter (wholesale general insurance firms) (January 2020):
 - *“How a firm handles non-financial misconduct throughout the organisation, including discrimination, harassment, victimisation and bullying, is indicative of a firm’s culture. We view both lack of diversity and inclusion, and non-financial misconduct as obstacles to creating an environment in which it is safe to speak up, the best talent is retained, the best business choices are made, and the best risk decisions are taken.*
 - *A senior manager’s failure to take reasonable steps to address non-financial misconduct could lead us to determine that they are not fit and proper. We expect firms and the Boards of firms to take this into account when considering the suitability and performance of (potential) senior managers and other senior leaders.”*

Prohibition Orders

- Recent decisions
 - Cochran – 7 years imprisonment
 - Jameson – 5 years imprisonment
 - Horsey – 9 months imprisonment
- Not fit and proper because they lacked “*the necessary integrity and reputation required to work in the financial services sector*”
- A sign of things to come, or the tip of the iceberg?
 - “*The FCA expects high standards of character, probity and fitness and properness from those who operate in the financial services industry and will take action to ensure these standards are maintained*”: Mark Steward



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ESMA's consultation paper on market data under
MiFID
Gabriel Lakeman

Policy objectives and background

- A key objective of MiFID II/MiFIR is to increase **transparency**
- Accordingly, MiFID II/MiFIR contains requirements which aim to increase the availability of market data for all market participants/users, including requirements on:
 - **Access on a reasonable commercial and non-discriminatory basis**: market data providers – *i.e.*, trading venues, systematic internalisers, APAs and CTPs – are required to make certain market data available on a reasonable commercial basis and on a non-discriminatory basis
 - **Free publication of “delayed data”**: particular market data providers, *i.e.* trading venues, APAs and CTPs, are required to make certain market data freely available 15 minutes after publication
- For these purposes, market data includes **pre- and post-trade transparency information**

Subsequent developments

- Following MiFID II/MiFIR coming into effect, market participants and regulators **have raised various concerns** around availability of market data
- Concerns have led to **regulatory interventions**:
 - Various ESMA Q&A on MiFID II and MiFIR transparency topics
 - ESMA Report on Market Data published December 2019
 - ESMA Roundtable on Market Data Issues June 2020
- Current **ESMA Consultation Paper on Guidelines on the MiFID II/MiFIR obligations on Market Data** published November 2020

Proposed Guidelines (1 of 2)

- Provision of market data on the basis of cost:
 - Guidelines require market data providers to have **clear, documented and up-to-date methodologies** for setting prices, and not to increase final cost through **onerous auditing processes** applied to market data users
- Obligation to provide market data on a non-discriminatory basis:
 - Guidelines set out requirements to ensure **customer categorisation is based on factual and verifiable criteria**, and on the application of fees and technical arrangements for access to customer categories
- Per user fees:
 - Guidelines aim to ensure “per user” fees are calculated at the **level of individual user IDs**, and to encourage market data providers to offer, and make easily available, per user fee arrangements

Proposed Guidelines (2 of 2)

- Obligations to keep data unbundled:
 - Market data providers to be subject to **unbundling requirements**
- Transparency obligations:
 - Guidelines set out a **standardised template** for making public information about fee arrangements, including information about the costs and margin included in fee calculations (however disclosure of precise amounts of margin is not required)
 - ESMA also proposes **standardised terminology** for policies and pricelists, and transparency on auditing requirements and retrospective application of fees
- Obligation to make market data available free of charge 15 minutes after publication:
 - Guidelines aim to ensure full post-trade data is made **readily available** and in a useful format, including requirements for provision of data in a **machine readable format**
 - ESMA is also proposing to clarify (and restrict) where **fees may be charged for delayed data** used to create value-added services

Next steps

- ESMA inviting responses from data providers and market data consumers
- Consultation open until 11 January 2021
- ESMA aiming to publish final report and final guidance by Q2 2021

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