

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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8 September 2021

Financial Regulation Monthly Breakfast Webcast

Overview





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The FCA's latest papers on the Investment Firms
Prudential Regime
Rob Moulton

Background

- PS21/9: Implementation of Investment Firms Prudential Regime
 - Follow on paper from CP21/7
 - Contains final rules on several areas including remuneration
- CP21/26: A new UK Prudential Regime for MiFID Investment Firms
 - 3rd (of three) IFPR consultations
 - Focuses on disclosure aspects
 - 17 September closing date
- Overall IFPR ethos remains tied largely to EU approach

Key definitions

- Non-SNI firm
 - A MiFID investment firm that is not an SNI
- SNI firm
 - AUM less than £1.2 billion; cash trades less than £100 million per day; derivatives trades less than £1 billion per day; no client money; no permission to deal on own account; on and off balance sheet less than £100 million, rolling four year average
- K-AUM
 - The K-factor linked to assets under management
- K-COH
 - The K-factor linked to client orders handled
- FOR
 - The K-factor linked to fixed overheads

PS21/9: Firms acting as clearing members

- Will be non-SNI firms by definition
- Question over default fund contribution risks
 - Was rated as 8%
 - Now, in light of feedback, rated as 1.6% for Qualifying CCPs, and 8% otherwise

Governance

- Non-SNI firms can use group Remuneration Committees in many circumstances (parent has to meet limited criteria)

PS21/9: K-AUM

- AUM includes non-discretionary advice of an ongoing nature
 - FCA points out this must relate to MiFID activity (without giving much explanation)
 - FCA includes additional guidance on “ongoing” nature of advice – to distinguish between ad-hoc advice of some frequency, and advice which is provided as part of an ongoing mandate
- Interaction between K-AUM and K-COH
 - Arises because dealing as agent will occur in relation to assets under management
 - FCA confirms overlapping scope
 - Complexity in relation to group consolidation requirements (because an inter-group transaction will be “caught” in relation to each entity but not in respect of the overall group calculation)

PS21/9: Remuneration

- Performance year “starting after 1 January 2022”
 - FCA confirms that it is the performance period start date, rather than the payment date, that is relevant in determining application
- Threshold for extended remuneration requirements
 - On and off balance sheet assets over preceding four year period is a rolling average of more than £300 million
 - Balance sheet assets is a rolling average of more than £100 million (but less than £300 million), and firm has trading book business of over £150 million and/or derivatives business of over £100 million
 - FCA rejected suggestions of aligning with the banking regime as “no firms would be caught”

PS21/9: Remuneration

- Threshold for extended remuneration requirements (cont.)
 - FCA thinks only a “small proportion” of individuals will be MRTs whose variable pay is above the limits
 - FCA sticks to the previously-consulted on limits (variable must be both less than £167k and less than 1/3 of overall remuneration)
- Consolidation
 - Rules only apply if the other entity is also above the IFPR thresholds
 - Rules apply only to MRTs within non-UK entities where they are responsible for UK business
- Deferral percentages and periods
 - FCA retains approach (40% - 60%: three years with more for larger payments and more senior managers)

CP21/26: Disclosure

- ESG disclosures will come in non-IFPR format
- Disclosure requirements generally apply to non-SNIs, or SNIs with Tier 1 Capital
- Disclosure regime also applies to UK parents

	SNI that has not issued AT1	SNI that has issued AT1	Non-SNI	Commodity and emission allowance dealer
Risk Management	No	Yes	Yes	Exempt for 5 years
Own Funds	No	Yes	Yes	Exempt for 5 years
Own Funds Requirements	No	Yes	Yes	Exempt for 5 years
Investment Policy	No	No	Yes – if larger non-SNI	Yes – if larger non-SNI
Governance Arrangements	No	No	Yes	Exempt for 5 years
Remuneration	Some	Some	Yes	Exempt for 5 years

CP21/26: Disclosure

- Risk management policy and objectives
 - Must explain the potential areas of risk / harm
 - FCA will not issue a template, and has provided limited guidance
- Own funds
 - Needs to cover key details e.g. investment type, maturity date, convertibility
 - There will be a template
 - Information to be provided on FOR, K-Factor requirements, approach to assessing overall adequacy
- Investment policy
 - Must contain key information such as country (by percentage), voting history, use of proxy advisors
 - FCA will provide a template

CP21/26: Disclosure

- Governance arrangements
- Risk committee
- Diversity policy
- Remuneration arrangements
 - Largest non-SNI firms will need information on deferral and vesting
 - All non-SNI firms will need to include information by type of MRT
 - All firms will need to provide quantitative information on: fixed variable; employee type; percentage in shares etc.

CP21/26: Resolution regimes

- Investment firms removed from UK resolution regime (by HMT)
- FCA content provided ICARA properly covers recovery and resolution planning
- To be kept under review

FCA disciplinary policy

- Amended to cover approach to disciplining unregulated parent holding companies



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The FCA consultation on diversity and inclusion on
company boards and executive committees
Anna Ngo and Sarah Gadd

Overview

- FCA has launched a consultation (CP21/24) setting out proposals to:
 - Increase transparency for investors on the diversity of listed company boards and executive management; and
 - Improve considerations of broader diversity aspects within diversity policies and related disclosures by listed companies
- Proposed changes to LRs and DTRs apply broadly to main market companies (including overseas issuers) but not AIM
- Complements the recent FCA/PRA Discussion Paper: ‘Diversity and inclusion in the financial sector’
- Consultation opened on 28 July 2021 and will close on 20 October 2021. FCA will seek to finalise the relevant rules by late 2021
- Requirements would apply to accounting periods starting on or after 1 January 2022, so reporting will appear in annual reports published in spring 2023

Context

- There has been some progress in the UK under voluntary initiatives to promote diversity (including Hampton-Alexander Review and Parker Review):
 - As of Jan 2021, women held 36.2% of FTSE 100 board positions (up from 32.4% in 2019) and women held 33.2% of FTSE 250 board positions (up from 29.6% in 2019)
 - As of March 2021, 81 FTSE 100 companies reported that they had a director from a minority ethnic group on their board (this was 52 in January 2020)
- However, there is lack of standardised and mandatory transparency about diversity on listed company boards
- Increasing interest in board diversity due to ESG investing

International approaches to promoting diversity on listed company boards

United States	Hong Kong	Japan	Australia	Singapore
<p>SEC recently approved Nasdaq's Board Diversity Objective which requires companies listed on Nasdaq to:</p> <ul style="list-style-type: none"> Publicly disclose board-level diversity statistics using a standardized template Have, or explain why they do not have, at least two "diverse" directors, including at least one director who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ+ 	<p>SEHK proposes to implement the following revisions to its Listing Rules and Corporate Governance Code:</p> <ul style="list-style-type: none"> Listed issuers with single-gender boards have a three-year transition period to appoint at least one director of the absent gender IPO applicants are not expected to have single-gender boards All listed issuers are required to set and disclose numerical targets and timelines for achieving gender diversity Boards are required to review the implementation and effectiveness of diversity policies annually 	<p>The Financial Services Agency in Japan recently revised its Corporate Governance Code to require companies to disclose a policy and voluntary measurable targets in respect of promoting diversity in senior management by appointing females, non-Japanese and mid-career professionals.</p> <p>They are also required to disclose human resource development policies ensuring diversity, including the status of implementation</p>	<p>Companies listed on the ASX are subject to Corporate Governance Principles which recommend that the board sets "measurable objectives for achieving gender diversity in the composition of the board, senior executives and workforce generally".</p> <p>For S&P/ASX 300 entities, this objective should be not less than 30% of directors of each gender</p>	<p>The Ministry of Social and Family Development has established the Council for Board Diversity (CBD) to promote a sustained increase in the number of women on boards of listed companies, statutory boards and non-profit organisations.</p> <p>This has set a target for the 100 largest listed companies of 20% women on boards</p>

Proposed changes to the LRs

- In-scope companies required to disclose in their annual reports whether they **meet specific board diversity targets on a “comply or explain” basis**. The targets are:
 - At least 40% of the listed company board should be women (including those self-identifying as women)
 - At least one of the senior board positions (Chair, Chief Executive Officer (CEO), Senior Independent Director (SID), or Chief Financial Officer (CFO)) should be held by a woman (including those self-identifying as a woman)
 - At least one member of the board should be from a non-white ethnic minority background (as referenced in categories recommended by the Office for National Statistics)

Proposed changes to the LRs

- In-scope companies that have not met all of the targets would be required to indicate the target(s) that have not been met and explain the reasons for not meeting the target(s)
- In-scope companies also required to **publish headline numerical data** in their annual reports on the composition of their board and on the most senior level of executive management by gender and ethnicity
- This data would be produced in a **standardised tabular format** – see following slides

Proposed changes to the LRs – standardized table for displaying gender diversity data

Gender	Number of board members	% of the board	Number of senior positions on the board (CEO, CFO, SID or Chair)	Number in executive management	% of executive management
Men (including those self-identifying as men)					
Women (including those self-identifying as women)					
Non-binary					
Not specified/prefer not to say					

Proposed changes to the LRs – standardized table for displaying ethnic diversity data

ONS ethnicity category	Number of board members	% of the board	Number of senior positions on the board (CEO, CFO, SID and Chair)	Number in executive management	% of executive management
White British or White Other					
Mixed/Multiple Ethnic Groups					
Asian/Asian British					
Black/African/Caribbean/Black British					
Other Ethnic Group					
Not specified/prefer not to say					

Proposed changes to the DTRs

- Amend an existing DTR provision (which broadly requires in-scope companies to disclose in their corporate governance statement the diversity policy as applied to their board) to:
 - Indicate that this disclosure should include how any diversity policies apply to the key committees of the board, specifically the committees on remuneration, audit, and nominations
 - Clarify that the aspects of diversity to which the diversity policy may relate could include, for example, ethnicity, sexual orientation, disability, and socio-economic background
- A separate guidance provision would be added to the DTRs to **encourage companies to include numerical data on the diversity** of the board and the committees referred to above

Considerations

- Agree with the comply/explain disclosure requirement which sets specific targets?
- Appropriate to cover overseas/smaller companies?
- Companies to consider their GDPR obligations
- FCA data strategy on diversity

A blue-toned background image featuring a financial line chart with multiple data series and a grid. The chart shows various peaks and troughs, suggesting market volatility. The overall aesthetic is professional and data-driven.

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The FCA's Business Plan and related consultation on
changes to its decision-making process

Gabriel Lakeman

FCA's Business Plan 2021/22

- FCA published its Business Plan for 2021/22 on 15 July 2021
- Occurring in the context of significant senior leadership changes at the FCA – including the appointment of Nikhil Rathi as CEO in October 2020
- Accompanied by a speech by Nikhil Rathi, setting out his leadership vision of a more innovative, more assertive and more adaptive regulator
- *"[T]he FCA must continue to become a forward-looking, proactive regulator. One that is tough, assertive, confident, decisive, agile. One that acts, acts fast – and where we can't act, engages enthusiastically with those who can"*

A more assertive regulator?

- Authorisations: FCA expects rejection rates to increase
- Risk tolerance: FCA strongly signalling that it is willing to accept greater risk of successful legal challenge – "for our colleagues that will not be seen as failure"
- Regulatory perimeter: the FCA has indicated it will be more active in reducing harm outside the regulatory perimeter
- Enforcement decisions: FCA to consult on fast tracking supervisory and enforcement actions, and making changes to the Regulatory Decisions Committee

Changes to the Regulatory Decisions Committee

- FCA published CP21/25 on 29 July 2021 proposing changes to issuance of statutory notices, required to exercise enforcement and supervisory powers
- Proposals include:
 - Significant broadening of the ability of FCA senior managers to make decisions via Executive Procedures, focusing on quick intervention to prevent harm
 - Corresponding reduction in focus of the RDC to significant misconduct cases, involving decisions to apply sanctions and disciplinary measures
 - Changes will also include limitations on ability to provide oral representations, and enable commencement of civil or criminal proceedings pursuant to Executive Procedures
- Targeting Policy Statement in November 2021

Other FCA priorities

- The FCA's consumer priorities
 - Financial promotions: FCA to (i) consult on changing rules for high-risk investments and authorised firms which approve financial promotions; and (ii) work with the Treasury to update the framework for approval of financial promotions
 - Payments: the FCA is working with HMT on the Payments Landscape Review
 - Consumer duty: FCA's consultation closed 31 July 2021; further consultation on proposed rules due end 2021
- The FCA's wholesale priorities
 - Primary and secondary markets: FCA continuing to review rules – including ongoing Listing Rules and MiFID II related consultations/changes
 - Appointed Representatives regime: the FCA is tightening supervisory expectations, and considering if more fundamental changes to the regime are required
- Accountability
 - FCA plans to report on certain key metrics from April 2022



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FCA Guiding Principles on design, delivery and disclosure of ESG and sustainable investment funds
Anne Mainwaring

FCA Guiding Principles on design, delivery and disclosure of ESG and sustainable investment funds

- FCA has published a letter to the chairs of authorised fund managers setting out its expectations on the design, delivery and disclosure of ESG and sustainable investment funds
- Purpose is to ensure that funds marketed with a sustainability and ESG focus describe their investment strategies clearly and any assertions made about their goals are reasonable and substantiated
- The guiding principles are there to ensure that any ESG-related claims are clear and not misleading, both at the time of application and on an ongoing basis, so that consumers can make informed choices
- FCA makes clear that it expects fund applications to improve in line with the Guiding Principles

Application of the Guiding Principles

- The guiding principles apply to FCA authorised investment funds
- The guiding principles are targeted at funds that make specific ESG-related claims (e.g. pursuit of a responsible or sustainable investment strategy and claims to pursue ESG/sustainability characteristics, themes or outcomes), not those that integrate ESG considerations into mainstream investment processes

The Guiding Principles

- The guiding principles comprise an overarching principle and three supporting principles that focus, respectively, on ‘design’, ‘delivery’ and ‘disclosure’. Each principle is accompanied by a set of ‘key considerations’
- **Overarching principle: Consistency**
 - A fund’s ESG/sustainability focus should be reflected consistently in its design, delivery and disclosure. A fund’s focus on ESG/sustainability should be reflected consistently in its name, stated objectives, its documented investment policy and strategy, and its holdings

The Guiding Principles

- **Principle 1.** The design of responsible or sustainable investment funds and disclosure of key design elements in fund documentation
 - References to ESG (or related terms) in a fund's name, financial promotions or fund documentation should fairly reflect the materiality of ESG/sustainability considerations to the objectives and/or investment policy and strategy of the fund
 - *“Where a fund integrates ESG considerations into mainstream investment processes (with no material ESG orientation in the fund design/strategy), we do not expect to see prominent ESG claims in the fund's name or documentation, or ESG positioned as a key part of that fund's offering”*

The Guiding Principles

- **Principle 2.** The delivery of ESG investment funds and ongoing monitoring of holdings
 - The resources (including skills, experience, technology, research, data and analytical tools) that a firm applies in pursuit of a fund’s stated ESG objectives should be appropriate. The way that a fund’s ESG investment strategy is implemented, and the profile of its holdings, should be consistent with its disclosed objectives on an ongoing basis
 - *“Where a firm uses ESG/sustainability research, data and analytical tools to support its fund delivery process, it should employ appropriate resources to oversee this. It should also consider due diligence on any data, research and analytical resources it relies upon (including when third-party ESG ratings, data and research providers are used) to be confident that it can validate the ESG/sustainability claims that it makes”*
 - *“The AFM should take into account whether a reasonable investor would consider that the fund’s holdings reflect any ESG/sustainability characteristics, themes or outcomes that have been disclosed or claims that have been made”*

The Guiding Principles

- **Principle 3.** Pre-contractual and ongoing periodic disclosures on responsible or sustainable investment funds should be easily available to consumers and contain information that helps them make investment decisions
 - ESG/sustainability-related information in a key investor information document should be easily available and clear, succinct and comprehensible, avoiding the use of jargon and technical terms when everyday words can be used instead. Funds should disclose information to enable consumers to make an informed judgement about the merits of investing in a fund. Periodic fund disclosures should include evaluation against stated ESG/sustainability characteristics, themes or outcomes, as well as evidence of actions taken in pursuit of the fund's stated aims



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The Upper Tribunal's recent decision on non-financial
misconduct and the fitness and properness test
David Berman

Introduction

- Upper Tribunal handed down its decision in *Jon Frensham v The FCA* on 31 August 2021
- Important case as it considers when an individual may be found to lack integrity as a result of non-financial misconduct, and what factors to consider in making this assessment
- First time the Upper Tribunal has considered a case where the FCA was seeking a prohibition order against an individual based on that individual's conviction for a criminal offence not involving dishonesty, in circumstances where the behaviour concerned was unrelated to the individual's regulated activity

Background

- FCA imposed a Decision Notice on Mr Frensham in October 2020, removing his approved person status and banning him from holding regulated roles in future
- The FCA had found that Mr Frensham lacked integrity and was not a fit and proper person as he had been convicted of a criminal offence and sentenced to 22 months in prison for attempting to meet a child under 16 following acts of sexual grooming
- Although not connected with his work, the events in question had occurred while Mr Frensham was an approved person
- The FCA had found that his deviation from the legal and ethical standards expected of someone in his position was fundamentally incompatible with his role as a financial adviser
- The FCA also argued as part of the case before the Tribunal that Mr Frensham lacked integrity because he had failed to be open and cooperative, and had withheld various information from the FCA (such as the fact of his arrest)

The Decision

- The Upper Tribunal upheld the FCA's original decision, but not for the same reasons
- Interestingly, the Tribunal found that it would not have reached the same conclusion as the FCA had it considered Mr Frensham's conviction alone
- However, the Tribunal found that the FCA's decision could be upheld because of the circumstances in which the offence was committed (Mr Frensham had been in breach of his bail conditions at the time) and due to Mr Frensham's failure to be open and cooperative with the FCA in a number of different respects

Considering integrity

The Upper Tribunal gave detailed consideration as to when an individual might be found to display a lack of integrity. Relevant considerations include:

- Integrity is a broader concept than honesty. However, the question is whether the individual lacked integrity in a way that is relevant to the ethical standards of the profession in question
- Professionals may be held to a higher standard than the general public, but are not required to be paragons of virtue
- The need for public trust in the profession means that some scrutiny of a person's private life is permitted, but only when conduct that is part of a person's private life realistically touches on their practice of the profession concerned and engages the question as to whether the individual poses a risk to consumers and to confidence in the financial system
- The decision-maker should consider whether public confidence in the profession would be harmed if the public, assumed to have knowledge of the facts, found that a person who behaved in a manner under scrutiny was able to continue to practice his or her profession

Implications

- Significant that the Upper Tribunal did not consider the fact of Mr Frensham's conviction alone, despite its seriousness, to indicate that he lacked integrity
- Approach to integrity is instructive for firms considering how to deal with instances of non-financial misconduct
- Will be very case-specific, but suggests that even serious instances of non-financial misconduct do not necessarily lead to a finding that the individual lacks fitness and propriety in a professional context

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[FCA Business Plan 2021/22: Firms Should Expect a More Assertive FCA](#)

[FCA Seeks to Improve Quality of ESG Fund Disclosures](#)

[IOSCO Consults on Regulation of ESG Data and Ratings Providers](#)

[FCA Consults on Post-Brexit Changes to PRIIPS Regulation](#)

[HM Treasury Initiates Post-Brexit Review of the UK's AML and CTF Regime](#)

[ESMA Statement Warns on Payment for Order Flow](#)

[UK to Adopt a New SPAC Listing Regime From 10 August 2021](#)

[ESMA Publishes Guidance on SPACs](#)

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