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12 October 2022

Financial Regulation Monthly Breakfast Seminar

Overview

- UK Regulatory Perimeter – FCA’s MTF guidance for crowdfunding, bulletin boards and voice brokers
- Diversity – Recent FSSC and City of London papers on socio-economic diversity
- MiFID II ESG – An update on ESMA’s Final Report on guidelines on the MiFID II suitability requirements
- FCA’s latest messages on Consumer Duty for senior managers and future regulatory changes

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UK Regulatory Perimeter – FCA's MTF guidance for crowdfunding, bulletin boards and voice brokers

Rob Moulton

Background

- New guidance to take into account the “evolution of the definition” and “technological developments”, to be reflected in the Perimeter Guidance Manual
- UK will then dispense with ESMA’s Q&As on the same topic
- Additional questions around introducing proportionate rules for smaller trading venues

Multilateral system definition

- Characteristics of a trading system
  - Includes markets functioning based only on a set of rules
  - Rules could be reflected in contracts or operating procedures
  - The FCA will consider role of the operator, the determination of who can access the system, monitoring performance and behaviour of users, remuneration of the operator
- Multiple third party buying and selling interests
  - Is the system, at the point of entry, designed to enable one person to interact with others?
  - Crucial difference from EU approach

Multilateral system definition (cont.)

- Interaction within the system
  - Takes the form of an exchange of information relevant to the essential terms (price, quantity etc.)
  - A system that enables this information to be inputted and responded to and allows trading interests to interact will be an MTF
  - System might match trading interests, or allow users to respond to others' trading interests
  - Execution within the system is not required by the definition
- Financial instruments
  - Must be MiFID financial instruments

Voice broking

- Arranging trades over the telephone is not sufficient to be an MTF
- A firm that operates a platform where trading interests are broadcast, and then engages in voice broking, would be operating a trading system

Internal crossing by portfolio managers

- A system crossing interests of a portfolio manager between funds is not a trading venue
- The portfolio manager is the only user, so there is no interaction of multiple third party trading interests
- What about different managers in the same group?

Blocking onto trading venues

- Use of LSE Rule 3000 does not amount to a trading venue
- Guidance suggests this is only if it is “consistent with the intention of the parties…to trade on a trading venue”
    - Confusing because parties may have no such intention, and rules require some trades to be on-venue

Crowdfunding platforms operating in primary markets

- Something of a hot topic, in particular in respect of private capital markets
- The FCA says there is a “distinction between the matching of funding interests and the interaction of trading interests”
- Crowdfunding platforms in which business funding requirements of an issuer (shares or bonds) that are expressed in an offer made to investors is not a multilateral system
- A platform to permit subsequent secondary market trading of such instruments could be a multilateral system

Bulletin boards

- No legal definition – UK MiFIR refers to “facilities where there is no genuine trade execution or arranging taking place in the system, such as bulletin boards used for advertising buying and selling interests”
- Not a multilateral system if trading interests are not able to interact in such a system
- Will be an MTF if bulletin board matches trading interests, allows users to respond within the system to others’ interests, or system permits users to enter into contracts
- The FCA accepts an operator of a bulletin board could provide contact details of one user to another so that they can contract bilaterally outside the system, or use template documentation provided they do so outside the system (but cannot complete details such as price, quantity)

Service company

- Regime has been left behind by legislative change (still refers to market counterparties and intermediate customers)
- Appears to be being revamped by the FCA

Potential future areas for change

- The FCA is seeking further feedback
    - Are there rules that create barriers to entry?
    - How is the existing service company regime working?
    - Could some firms be subject to a “more scalable set of requirements”?

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Diversity – Recent FSSC and City of London papers on socio-economic diversity

Nell Perks

FSSC Insight Paper

- Understanding socio-economic background of workforce
- Over-reliance on individuals from higher socio-economic backgrounds at leadership level
- Progression gap
- Class pay gap

FSSC Insight Paper (cont.)

- How to measure socioeconomic background
  - Financial and Professional Services Toolkit
    - 3 key questions:
      - What was the occupation of your main household earner when you were about aged 14?
      - What type of school did you attend for the most time between the ages of 11 and 16?
      - Were you eligible for free school meals at any point during your school years (if you finished school after 1980)?
    - For graduates:
      - Did either of your parents attend university and gain a degree by the time you were 18?
  - Deepen understanding of workforce
  - Understand economic advantage/disadvantages
  - Social Mobility Employer Index survey

FSSC Insight Paper (cont.)

- Enablers to measurement of socioeconomic background
  - Senior sponsorship
  - Survey design
  - Simplified process
  - Rollout plan
  - Effective communication

FSSC Insight Paper (cont.)

- Aim:
    - Goals that address specific findings
    - Review processes and practices
    - Monitor progress
    - Attract and retain necessary skills and talent

Building the baseline: Breaking the class barrier

- Lack of socio-economic diversity at senior levels
  - Importance of data collection
  - Driver of better outcomes
  - Regulator attention
- Inclusion of employees from working class backgrounds
  - Senior sponsorship
  - Productivity and retention
  - Perception gap
- Compounding other diversity indicators

Building the baseline: Breaking the class barrier (cont.)

"*For the financial and professional services sector to tackle important solutions to the issues we are facing, it is imperative they have this diversity and inclusion. By having greater diversity and inclusion, these organisations are also able to drive profits, increase productivity and foster innovation*".

"*Diversity and inclusion are central to our role as regulators, as employers and public bodies*" – FCA and PRA, July 2021

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MiFID II ESG – An update on ESMA's Final Report on guidelines on the MiFID II suitability requirements

Jonathan Ritson-Candler

ESMA Final Report

- ESMA published its final guidelines on certain aspects of the MiFID II suitability requirements on 23 September 2022
- Revising these guidelines was driven by Delegated Regulation 2021/1253 ("**Delegated Regulation**") which amends Delegated Regulation 2017/565 in relation to various suitability obligations to integrate sustainability preferences
- The Delegated Regulation has applied since 2 August 2022
- However, ESMA has said that the revised Guidelines will apply 6 months after 23 September 2022 (rather than 2 months as originally proposed)
- Does not change application date of Delegated Regulation
- Primary change is that firms undertaking a suitability assessment must collect information on the client's "sustainability preferences"

Sustainability preferences

- Means a client's or potential client's choice as to whether and, if so, to what extent, one or more of the following financial instruments shall be integrated into their investment:
  - A financial instrument for which the client or potential client determines that a minimum proportion is invested in "environmentally sustainable investments" (as defined in the Taxonomy Regulation)
  - A financial instrument for which the client or potential client determines that a minimum proportion is invested in "sustainable investments" (as defined in SFDR)
  - A financial instrument that considers "principal adverse impacts" on sustainability factors where qualitative or quantitative elements demonstrating that consideration are determined by the client or potential client (as defined in Tables 1 to 3 in Annex 1 of Commission Delegated Regulation (EU) 2022/1288)

Impact of sustainability related changes in the Guidelines

- Sustainability preferences should only be addressed once suitability has otherwise been assessed and the product is otherwise aligned with the client's knowledge and experience, financial situation and other investment objectives. Sustainability preferences are a "second step"
    - Rationale being that sustainability factors should not take precedence over a client's personal investment objective
- Where clients have no sustainability preferences or actively respond "no" or "none", firms can label them as "sustainability neutral" and recommend products both with and without sustainability related features
- However, firms are under a positive obligation to explain to clients the meaning of each limb of sustainability preferences and staff must be appropriately trained to explain these terms to clients in a clear way and to explain the differences between products with and without sustainability features

Impact of sustainability related changes in the Guidelines

- Firms must actively refresh their suitability procedures to capture sustainability preferences in a sufficiently granular way to allow matching of sustainability features of products with those preferences
  - Clients can express their sustainability preferences as one of more of the three limbs and firms must record information in relation to each
  - For example, in relation to products with a “minimum proportion” firms should capture what this means by providing clients with ranges to select (e.g., minimum 20%, 25% etc.)
  - For PAI, firms must record whether clients have quantitative and/or qualitative views
- Firms should ask clients what percentage of their overall portfolio (if any) they want invested in products that match their sustainability preferences

Impact of sustainability related changes in the Guidelines

- For ongoing relationships – refresh of suitability assessment to include sustainability preferences can take place at next scheduled refresh but no later than 12 months from 2 August 2022 (application of Delegated Regulation)
- Clients must be given opportunity to have their profile updated immediately if they wish
- Sustainability factors must be built into suitability assessment for all new clients

Product governance overlap and impact on manufacturers

- Similar ESG related changes being made to the product governance rules, which will apply from 2 November 2022
- ESMA has read across “sustainability preferences” from suitability into how firms might look to set a “sustainability factors” target market for product governance i.e., if the product meets any of the three limbs, it can have a positive sustainability target market for that limb
- ESMA also added a 4th catch all category for those products that do not yet fall within the sustainability preference limbs but otherwise “have a focus on either environmental, social or governance criteria or a combination of them”

Product governance overlap and impact on manufacturers

- Given product governance compliance date is rapidly approaching, we're seeing most manufacturers default to assigning a neutral sustainability factors target market as few products currently fall into the three sustainability preferences limbs, whilst developing an approach for assigning a positive target market for products that fall into the 4th category
- Given the detailed suitability related sustainability preferences obligations on distributors, we understand that there is pressure on manufacturers to provide products that have a positive sustainability factor target market
- Initially, we see the 4th category as likely being the most used for assigning any positive target market
- However, the 4th category does not map across to the sustainability preferences on which distributors are collecting suitability information

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FCA's latest messages on Consumer Duty for senior managers and future regulatory changes

Becky Critchley

Consumer Duty – Recent messaging

- Senior buy in and engagement is key:

  "… *change won't be possible unless driven from the top with strong senior championing and oversight*"

  "*We want firms' Boards and senior management to ensure that good outcomes for consumers are central to their firm's culture, strategy and business objectives*"

- Expectation that firms will consider the Consumer Duty now

Consumer Duty – Messages for Boards

- What do boards need to do?
    - Sign off on Consumer Duty implementation plans by 31 October 2022
    - Scrutinise and challenge plans to ensure they are deliverable and robust to meet the new standards
    - To be given assurance that the Consumer Duty will be fully implemented for new and existing products by July 2023
    - Ongoing role overseeing these plans and ensure they remain on track
    - Ensure good record keeping – expect FCA to ask for documents

Consumer Duty – Consumer Duty Champion

- Consumer Duty Champion
- At Board level and an independent non-executive director (where appropriate to the firm)
- The primary role of the Champion is to support the Chair and CEO in ensuring that that
    - i) The Consumer Duty is being raised regularly in all relevant discussions, and
    - ii) The Board is challenging the firm's governing body/management on how it is embedding the Consumer Duty and focusing on consumer outcomes
- <u>Not</u> responsible for the firm's implementation of the Consumer Duty but for ensuring it is discussed at the Board
- <u>Not</u> a prescribed responsibility

Consumer Duty – Messages for Senior Management

- Recap: SMCR - senior management responsibility for complying with the requirements and standards of the regulatory system
- Senior managers should:
  - Be clear about what they are responsible and accountable for
  - Satisfy themselves on scoping and implementation
  - Ongoing oversight
  - Expect to be asked by the FCA about the role that they will play in delivering good outcomes for customers
- Consider the application of the individual conduct rule to Consumer Duty compliance

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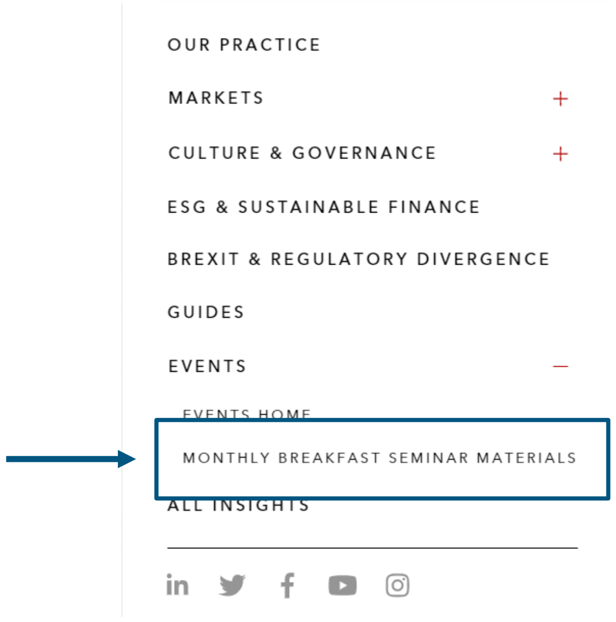

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An easy to use toolkit that enables organisations globally to monitor, evaluate, and shape their workplace culture.

The recently updated fourth edition explores developments relating to ESG, hybrid working, diversity and inclusion, bedrock cultures, whistleblowing, and bystander employees.

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Non-Financial Misconduct in Financial Services and Parliament

Join us for a lively discussion based on real-life case studies as we address the complexities of non-financial misconduct and consider lessons to be learned from the continuing ‘party-gate’ saga.

This session will explore non-financial misconduct's relevance within the financial services context, recent legal developments, and ways to establish practical boundaries.

We will be joined by Beth Rigby, Political Editor at Sky News. Beth has worked as a political journalist for nearly a decade, covering two general elections, the Scottish independence and EU referendums, and all the twists and turns of Brexit.

WEDNESDAY

2 November 2022

8:30 – 10:30 a.m.

REGISTER

Drapers' Hall

Throgmorton Avenue
London, EC2N 2DQ

Speakers

Beth Rigby
Political Editor
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