

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 fluctuations. The overall aesthetic is professional and data-oriented.

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15 June 2022

Financial Regulation Monthly Breakfast Seminar

Overview



Upcoming UK regulation of critical third parties

ESG latest, including SFDR-RTS guidance, the SEC's response to SFDR, and ESMA's guidance on sustainability risks and disclosures in investment banking

FCA's Primary Markets Effectiveness Review and Primary Markets Bulletin 40



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Upcoming UK regulation of critical third parties
Jonathan Ritson-Candler

HM Treasury confirms it will introduce a critical third party regime applicable to unregulated firms

- On 8 June 2022, HMT published a policy statement confirming that the government will legislate to create a critical third party (“CTP”) regime when Parliamentary time allows
- Intended to address concern of the risk posed by regulated firms’ outsourcing of critical services to unregulated third parties
- CTP regime intended to be complementary to (and not replace) regulated firms’ operational resilience obligations and give regulators powers in relation to the material services provided by third parties
- HMT, BoE, PRA and FCA intend to publish a joint Discussion Paper providing details of how any powers granted to them in legislation will be exercised, followed by a CP and then a final PS – timing is TBC

Objectives of the CTP regime

- HMT has observed that financial services firms and financial market infrastructure firms are increasingly relying on third parties outside of the financial services sector for key functions or services (e.g., cloud-based computing services)
- Concern is that where numerous firms rely on the same or a small group of third party providers, the failure or disruption of a “critical” third party could threaten the stability of, or confidence in, the UK’s financial system
- Will empower regulators with direct supervisory oversight and enforcement powers in relation to third parties they designate as “critical”
- View is that the operational resilience regime applicable to regulated firms is insufficient to mitigate this risk – no single firm can upwards manage these risks

Defining third party firms as critical

- HMT, in consultation with BoE, PRA and FCA, will be able to designate certain third party firms as critical
- Designation framework will be set out in primary legislation and the designation itself of firms as critical will be done by way of secondary legislation
- BoE, PRA and/or FCA may recommend to HMT that certain firms are designated as critical based on information they already possess
- HMT will also consider representations of firms that are potentially critical

Powers over CTPs

- Once designated as CTPs, regulators will have a range of supervisory and enforcement powers in relation to the “material services” that CTPs provide to the financial services sector
- Remains to be seen both how services are determined to be material but also the boundaries of the regulators’ powers over only those services vis-à-vis otherwise unregulated firms

Powers over CTPs

- Regulators will have the power to:
 - Set minimum resilience standards and require CTPs to take part in “targeted forms of resilience testing”
 - Request information directly from CTPs on the resilience of their material services to firms, or their compliance with applicable requirements
 - Commission an independent skilled person to report on certain aspects of a CTP’s services
 - Appoint an investigator to look into potential breaches of requirements under the legislation
 - Interview a representative of a CTP and require the production of documents
 - Enter a CTP’s premises under warrant as part of an investigation
 - Direct CTPs to take or refrain from taking specific actions
 - Publicise failings
 - Take enforcement action such as to prohibit a CTP from providing future services or continuing to provide services to firms

Potential implications of the CTP regime

- Query how the regulators will develop objective criteria that deliver transparent, consistent results in terms of designating third party firms as “critical”
- Potentially controversial to extend the regulators’ powers over firms that are otherwise entirely outside of the financial services sphere – particularly in light of current capacity / resources issues at the FCA
- Unclear how regulators will balance the desire to regulate CTPs with ensuring the UK remains an attractive and competitive jurisdiction for, for example, tech firms to do business
- Risk of regulatory creep beyond “material services” provided by CTPs (compare to issues faced by cryptoasset service providers being regulated, currently, only for AML and CTF compliance)



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ESG latest, including SFDR-RTS guidance, the SEC's response to SFDR, and ESMA's guidance on sustainability risks and disclosures in investment banking
Anne Mainwaring or Nicola Higgs

SEC: ESG disclosure requirements for investment advisors & registered funds

- **25 May 2022:** SEC proposed rules to require registered and exempt investment advisers (Advisers) as well as registered investment companies (**Registered Funds**) to provide standardised ESG disclosures to their investors
- SEC also proposed amendments to Rule 35d-1 (the **Names Rule**), which governs naming conventions for Registered Funds:
 - Expand the scope of the current 80% investment policy requirement to apply to any Registered Fund name that includes terms that suggest the fund focuses on investments that have, or whose issuers have, particular characteristics, as well as enhance related disclosure, reporting, and record-keeping requirements

SEC: ESG disclosure requirements for investment advisors

- Registered investment advisers would be required to add the following
- disclosures to their ADV Part 2A brochures if they consider ESG factors in connection with any significant investment strategy or method of analysis:
 - a description of the ESG factor(s) considered and how they are incorporated into the adviser's investment recommendations;
 - an explanation of whether and how the adviser employs **ESG integration, ESG-focused strategies, or ESG impact strategies**
 - if applicable, a description of any ESG criteria or methodology used in investment evaluation or selection;

SEC: ESG disclosure requirements for investment advisors

- a description of any relationship or arrangement material to an adviser's business or clients that the adviser or its management persons have with any related person that is an ESG consultant or ESG service provider;
- for advisers with specific voting policies or procedures that include one or more ESG considerations, a description of those factors and how they are considered in voting client securities; and
- for advisers sponsoring wrap fee programs, an explanation of whether they review, or whether a third party reviews, portfolio managers' application of relevant ESG factors and the nature of such review, or an affirmative statement that no such review occurs and an explanation of any limitations on calculation, assessment, or presentation of ESG factors as a result

SEC: ESG disclosure requirements for registered funds

- Registered Funds (except UITs) that consider ESG factors in the investment process must be classified as either an “Integration Fund” or an “ESG-Focused Fund”
 - **Integration Funds** are defined as Registered Funds that consider ESG factors in their investment selections but in which ESG factors are “generally no more significant than other factors in the investment selection process, such that ESG factors may not be determinative in deciding to include or exclude any particular investment in the portfolio”
 - **ESG-Focused Funds** are defined as Registered Funds that have one or more ESG factors as a significant or main consideration in (1) investment selection or (2) engagement with the Registered Fund’s portfolio companies. This would include any Registered Fund that markets itself (whether through its name or marketing materials) as having an ESG focus

SEC: ESG disclosure requirements for registered funds

- If an ESG-Focused Fund also focuses on achieving a specific impact (e.g., improving water quality, supporting affordable housing, etc.), then it would also be considered an “**Impact Fund**” and would be subject to additional requirements specific to Impact Funds
- Disclosures would be required in two main places: (1) a Registered Fund’s prospectus and (2) its annual reporting, including on Form N-CEN as appropriate

US v EU: ESG disclosure requirements

US	EU	UK
<ul style="list-style-type: none">➤ In the absence of a EU Taxonomy equivalent, the SEC proposal instead mandates disclosure of certain metrics, currently limited to climate, and allows investors to decide whether they are sufficiently aligned with sustainability/ climate objectives	<ul style="list-style-type: none">➤ Applies to financial advisers and “financial market participants,” which form a considerably larger set of entities than that covered in the SEC proposals, notably including private equity, private credit, venture capital, and other alternative investment funds that are not captured by the SEC proposals➤ EU SFDR prescribes both entity-level disclosures and three sets of product-level disclosures (pre-contractual, periodic, and website) for financial market participants➤ Scope 3 emissions must be taken into consideration under the EU SFDR as part of the application of the principal adverse impact indicators for financial products that make sustainable investments➤ EU SFDR assumes many more metrics and provides more detailed guardrails on what may generally be deemed “sustainable” than under the SEC’s proposed rules	<ul style="list-style-type: none">➤ TBD July 22...

ESMA Supervisory Briefing: sustainability risks and disclosures in the area of investment management

- ESMA has developed this supervisory briefing to promote convergence on the supervision of sustainability-related disclosures as well as the supervision of how fund managers integrate sustainability risks in their organisational framework and decision-making process
- Provides guidance to NCAs regarding the supervision of sustainability-related disclosures and integration of sustainability risks
- Part of the actions to implement ESMA's Sustainable Finance Roadmap, namely the consistent implementation of new requirements applicable to asset managers
- Proportionality in supervision

SFDR pre-contractual disclosures

- NCAs are invited to create a checklist based on the information to be provided in the pre-contractual templates that will help assessing the compliance of the disclosures of new and existing funds disclosing under Article 8 or 9 SFDR (and Article 5 or 6 TR)
- Minimum verification requirements

Presentation of disclosures

- Boilerplate language
- Use of cross references and hyperlinks
- Manner of disclosure

Principles-based guidance on fund names

- Funds' names should not be misleading, as the disclosure of sustainability characteristics should be commensurate with the effective application of those characteristics to the fund
- The use of terms such as “ESG”, “green”, “sustainable”, “social”, “ethical”, “impact” or any other ESG-related terms should be used only when supported in a material way by evidence of sustainability characteristics, themes or objectives that are reflected fairly and consistently in the fund's investment objectives and policy and its strategy as described in the relevant fund documentation

Principles-based guidance on fund names

- *“While there are no legal grounds under SFDR to prohibit a fund disclosing under Article 8 SFDR which does not include any sustainable investments from using the terms “sustainable” or “sustainability” in its name, it is advisable, in order to avoid confusion with investors, that the use of the term “sustainable” or “sustainability” should be used only by (1) funds disclosing under Article 9 SFDR, (2) funds disclosing under Article 8 SFDR which in part invest in economic activities that contribute to environmental or social objectives and (3) funds disclosing under Article 5 TR”*

Integration of sustainability risks by AIFMs and UCITS managers

- All authorised fund managers are required from 1 August 2022 to integrate sustainability risks in their portfolio and risk management processes and overall governance structure
- NCAs should verify compliance of the UCITS management companies and AIFMs with these requirements by checking the description of the manner in which sustainability risks are integrated in their investment decisions in pre-contractual fund disclosures referred to in Article 6 SFDR and ensuring that UCITS management companies and AIFMs perform a review of the relevant internal policies and procedures on a periodic basis

Regulatory interventions in case of breaches

- A shift towards enforcement?

Clarifications on the ESAs' draft RTS under SFDR

- ESA statement to promote a better understanding of the disclosures required under the technical standards of the SFDR ahead of the planned application of the rules on 1 January 2023
- Statement is in relation to the draft RTS

Sustainability indicators

- Confirmation from the ESAs that “sustainability indicators” (i.e. indicators used to measure the Environmental and / or Social characteristic or the overall sustainable impact of the Financial Product (“FP”) are not the same as the PAI indicators in the RTS (i.e. those in Table 1 -3 of Annex 1)
- ESAs confirm that there is some overlap between the two concepts as the PAI indicators can also be used to measure the E/S characteristics, i.e. my showing improvements of the investments against those indicators over time

Do no significant harm (DNSH)

- DNSH assessment requires an explanation of how the sustainable investment does not significantly harm any sustainable investment objective with reference to how the indicators for adverse impacts in Table 1 of Annex I, and any relevant indicators in Tables 2 and 3 of Annex I, are taken into account
- For the financial product's DNSH disclosures, the ESAs' did not set out any additional criteria for the taking into account of the adverse impact indicators in Annex I - based on the definition of sustainable investment, the ESAs consider that financial market participants can determine whether the indicators have been respected for the purpose of disclosing that the investment has not significantly harmed any environmental or social objective

Do no significant harm (DNSH)

- ESA's emphasise the point that the use of PAIs for DNSH test is separate from the Article 4 and Article 7 SFDR PAI disclosures

Taxonomy

- Disclosures of “minimum proportions” of Taxonomy aligned investments in pre-contractual disclosures should be viewed as “binding commitments” (to ensure transparency on taxonomy for end investors)
- Penalties for failure to comply would be the same as for failing to comply with other binding product commitments



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FCA's Primary Markets Effectiveness Review and
Primary Markets Bulletin 40
Johannes Poon

FCA's primary markets effectiveness review

- DP22/2 published on 26 May 2022. Feedback requested by 28 July 2022
- Follows CP21/21 which sets out four different models for structuring the UK listing regime
- Key proposal - replace current premium and standard segments with a single listing segment for equity shares of commercial companies

FCA's primary markets effectiveness review – single listing segment

- Single Segment:
 - One set of eligibility criteria
 - Continuing obligations: Mandatory + (optional) Supplementary
- Transitional arrangements for existing issuers
- Scope
 - Retain separate listing requirements for securities other than equity shares in commercial companies (such as SPACs and GDR listings)
 - Overseas incorporated companies have choice to seek a secondary listing or list via single segment
- Reaction of index providers and IPCs?

FCA's primary markets effectiveness review – other proposals

- Substitute financial eligibility conditions with a disclosure-based regime
- Significant transactions regime (i.e. Class 1 transactions)
- Dual class shares
- Sponsor regime – extend to cover all listed companies under single segment. Improvements to record keeping, conflicts of interest and transparency around fee structures

Primary Markets Bulletin 40

- Updates to the FCA's Knowledge Base in relation to the prospectus regime
- Largely to reflect the Prospectus Regulation which replaced the Prospectus Directive in July 2019
- Effective from 27 May 2022

Primary Markets Bulletin 40

- New Guidelines on disclosure requirements under the Prospectus Regulation (Primary Market/TN/619.1)
 - Based on the ESMA Guidelines but with some deviations (not adopted aggregation approach for pro forma financials and working capital calculation for closed ended investment funds) – see PMB 34 and 40
 - Carries over the CESR recommendations relating to specialist issuers
 - Replaces the CESR recommendations
- Other Procedural and Technical Notes – updates and new content
 - Consequential changes to a number of notes including changes to reflect the Prospectus Regulation and Brexit
 - Certain elements of the ESMA PD Q&As have been incorporated into FCA guidance
 - ESMA’s PR Q&As and other guidelines on the PR remain relevant (PRR 1.1.5G)

RESCHEDULED Non-Financial Misconduct in Financial Services and Parliament

WEDNESDAY

2 November 2022

8:30 – 10:30 a.m. BST

Drapers' Hall
Throgmorton Avenue
London, EC2N 2DQ

REGISTER

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.

Speakers



[Beth Rigby](#)

Political Editor
Sky News



[David Berman](#)

Partner
London



[Jon Holland](#)

Partner
London



[Rob Moulton](#)

Partner
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[FCA Proposes to Unify the Listing Regime for Commercial Companies Under a Single Listing Segment](#)

[Sanctions Update: EU Expands Sanctions and Export Controls Relating to Russia and Belarus](#)

[Law Commission Proposes Reforms to Corporate Criminal Liability in the UK](#)

