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# Financial Regulation Monthly Breakfast Webcast

13 November 2024

LATHAM & WATKINS



# Today's Topics

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An update on investment research in the UK and EU Rob Moulton

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The Court of Appeal decision on commissions in the motor finance market, and its potentially wider ramifications for payments to third parties Becky Critchley

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FCA's feedback from its survey on non-financial misconduct Nell Perks

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FCA PS24/14 on bond and derivative market transparency, and the SI regime Rob Moulton

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The PRA and FCA speeches on international competitiveness and growth Nicola Higgs

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# An update on investment research in the UK and EU

**Rob Moulton**

# Investment research payment optionality – UK

- FCA has already introduced CSA+ arrangements in the UK (but rebundling is not permitted)
- New consultation on the application of this regime for non-MiFID managers (rules in COBS 18 and COLL)
- Largely mirror the restrictive approach taken by PS24/9
- However, even more restrictive for non-MiFID managers as budgets, disclosures, and cost allocations are proposed to be at individual fund and client (rather than aggregated) level

# Investment research payment optionality – EU

- Listing Act already provides for greater future flexibility than in the UK
  - Full rebundling permitted
  - Will therefore (silently) also permit a more workable CSA model
- New ESMA guidance 28 October 2024
- Key new guideline requires managers to “enter in an agreement” without “pay[ing] substantially more for the research...than paid directly” and without impacting upon their “ability to comply with the best execution requirements”





The Court of Appeal decision on  
commissions in the motor finance  
market, and its potentially wider  
ramifications for payments to  
third parties

**Becky Critchley**

# Background

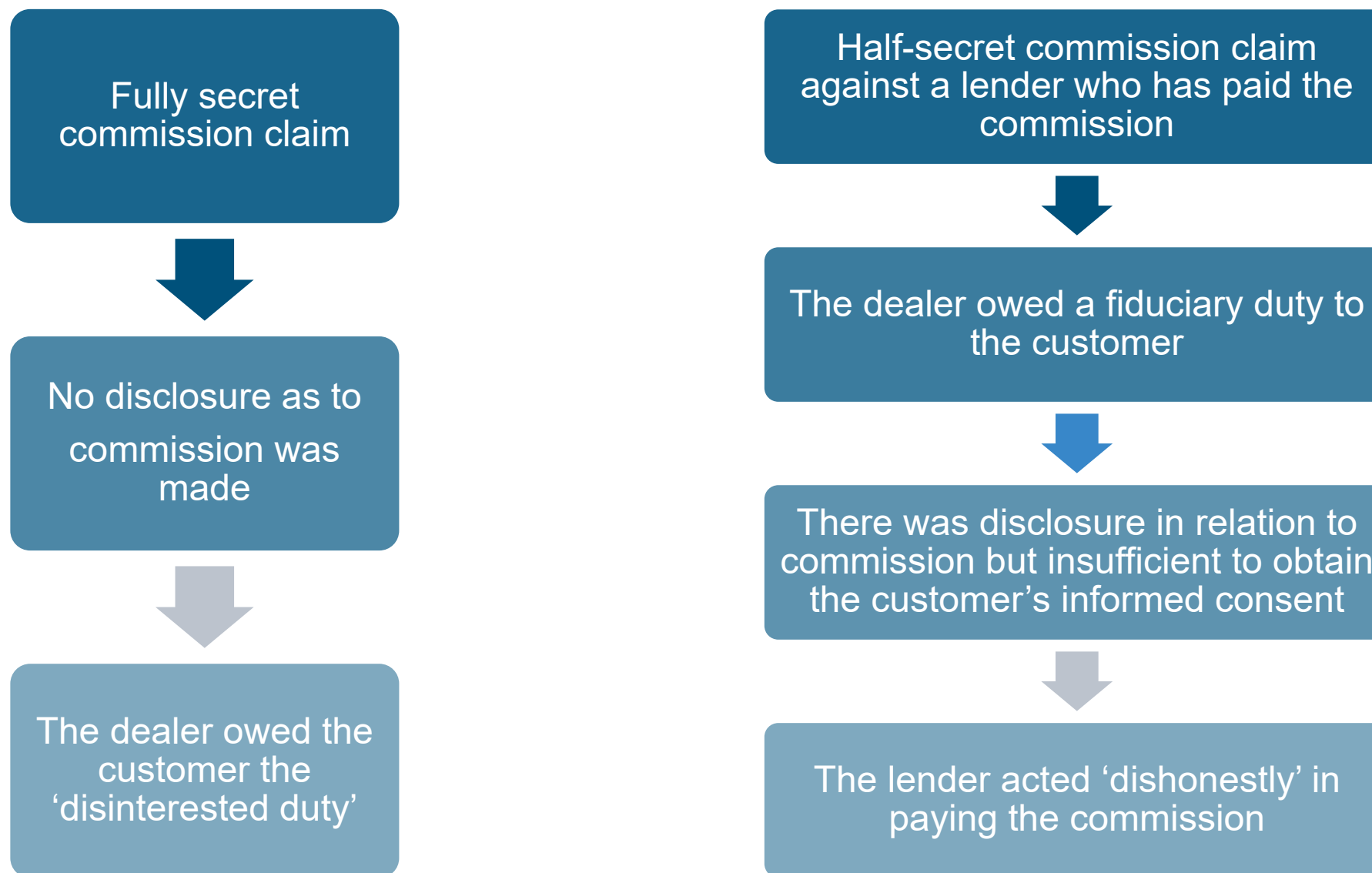
- FCA ban on discretionary commission models from 28 January 2021
- General increase in complaints and claims relating to discretionary commission models
- 10 January 2024 Financial Ombudsman decisions
  - Judicial review application
- 11 January 2024 FCA publications
  - Complaints handling deadline extended to 37 weeks
  - FCA market wide s166
  - 24 September 2024 initial date for FCA conclusion
- 30 July 2024
  - FCA extended complaints handling deadline to 4 December 2025
    - Consumers given until the later of 29 July 2026 or 15 months from the date of their final response letter from the firm, to refer a complaint to the Financial Ombudsman
  - FCA conclusion due by end of May 2025

# Court of Appeal decisions in Johnson, Wrench and Hopcraft

- 25 October 2024 Court of Appeal judgment handed down
- Appeals by the borrowers allowed in their entirety
- Decisions not predicated on there being a discretionary commission model used
- Five key issues dealt with in the appeal:
  1. Did the car dealers owe: (i) a disinterested; and (ii) a fiduciary duty to the claimants?
  2. Does the reference to the fact a commission may/will be payable in the finance agreement terms and conditions mean that secrecy has been negated?
  3. If there was partial disclosure sufficient to negate secrecy, was there fully informed consent?
  4. What is necessary to establish the accessory liability of a lender in partial disclosure cases?
  5. Was the relationship unfair under section 140A of the Consumer Credit Act 1974?



# Key components of a successful claim



# What's next?

- Appeal to the Supreme Court
  - Timing unclear
- Updated disclosures for finance brokers
- Impact on FCA review
  - Nikhil Rathi comment at IA Annual Dinner
- Broader impact?







FCA's feedback from its survey  
on non-financial misconduct

**Nell Perks**

# What and why?

- First comprehensive non-financial misconduct data gathering exercise
- Over 1,000 investment banks, brokers, and wholesale insurance firms
- 3-year period: 2021 to 2023
- Recorded incidents of non-financial misconduct
- Aim: to acquire a baseline assessment of behaviours
- Purpose in sharing the findings:
  - Allow boards to understand the position at their firms relative to others
  - Enable trade associations to coordinate
  - Inform the public and other stakeholders



## What and why? (cont.)

A corporate culture that tolerates sexual harassment or other non-financial misconduct is unlikely to be one in which people feel able to speak up and challenge decisions, or one in which they will have faith that concerns will be independently and fairly assessed. Such a culture also raises questions about a firm's decision making and risk management

All firms must be fully compliant with their existing regulatory responsibilities and reporting requirements. We will use the responses to the survey to inform our supervisory and policy work. We will act where firms fail to adhere to our rules

We think that this collective process will help to drive continued positive momentum on improving culture in financial firms

# Findings – distribution of types

- Varied by sector
- Most reported across all sectors:
  - Bullying and harassment
  - Discrimination
- Lowest across all sectors:
  - Possession and use of illegal drugs
  - Violence and intimidation
- Wholesale banks had lowest reported incidents of sexual harassment (6%)
- 41% of non-financial misconduct incidents reported in the ‘other’ category:
  - Intoxication or misuse of alcohol
  - Data protection and IT security breaches
  - Retaliatory behaviour in relation to allegations made
  - Misuse of expenses or gifts and hospitality
  - Performance issues and related conduct breaches
  - Breaches of firms’ policy and procedures



# Findings – identification of incidents

- Grievances or ‘other formal escalation processes’ detected over 50% of incidents
- Wholesale banks more likely to have incidents with multiple detection methods
- Whistleblowing: 32% wholesale banks; 15% insurers; 10% brokers; 6% intermediaries
- Monitoring and surveillance: number of instances detected relatively small
- Respondents from all portfolios reported ‘other’ detection methods, including:
  - Reports from third parties who had witnessed misconduct
  - Informal concerns raised with human resources function, compliance function or line managers
  - Line managers taking a proactive approach to identifying misconduct

All firms should consider a variety of complementary methods for identifying non-financial misconduct to improve detection and for considering information that comes in from different sources

Encouraging a robust speak-up culture is important, alongside safe avenues for reporting, such as whistleblowing

# Findings – outcomes

- Number of reported incidents not investigated was very low across all sectors – 1-2%
- Written warnings were the most common outcome (21-36%), except for wholesale banks (only 12%)
- Besides dismissal, written warning, verbal warning, a number of ‘other’ outcomes were reported, including:
  - Mediation between parties leading to resolution
  - Management training or coaching
  - Employee resignation



# Findings – outcomes (cont.)

- Incidents most likely to lead to dismissal:
  - Possession or use of illegal drugs (21%)
  - Sexual harassment (22%)
  - Violence or intimidation (21%)
- Number of confidentiality and settlement agreements signed fell between 2021 and 2023
- Remuneration adjustments:
  - Fairly low numbers with variation to unvested pay more likely
  - Little or no clawback (0% or 1%) and very low fixed pay adjustment (1% to 3%)

# Findings – governance

- Whistleblowing policies: not all respondents had them. SYSC 18.3.1 requires up to date and readily available procedures.
- Remuneration policies: 92% wholesale banks; 84% wholesale brokers; 80% insurers; only 46% intermediaries
- Documented D&I strategy: 70% wholesale banks; 71% insurers; 58% intermediaries; 48% brokers
- 38% respondents said board (or board level committee) did not receive MI about non-financial misconduct
- 33% respondents said they had no formal governance structure or committee to make decisions about outcomes for those involved in non-financial misconduct

Firms should benefit from safer and healthier cultures and may gain a competitive advantage if: they safeguard their culture with effective and fair governance their board and senior management can monitor the results through accurate MI

# Findings – regulatory references

- Steady increase in number of regulatory references that contain information relating to non-financial misconduct
  - 92% of respondents would include incidents of non-financial misconduct in a regulatory reference
  - 87% of respondents would update a regulatory reference following a non-financial misconduct incident
- Number of individuals hired where an incident of non-financial misconduct was on a regulatory reference halved across the three-year period
- Steady increase in amending employees' Fit and Proper assessments

A senior manager's failure to take steps to address non-financial misconduct could lead us to determine that they are not fit and proper



# Next steps / FCA expectations.

## FCA expects firms to do four things:

1. Reflect on the data and consider how their own performance compares with their peers
2. Discuss non-financial misconduct at senior management and board level and consider whether they need to take steps to improve:
  - Their culture
  - How they identify and manage risks
  - How they address non-financial misconduct on an ongoing basis
3. Share good practice across firms, for example through trade association forums
4. Review their systems and controls to:
  - Enable employees to speak up about non-financial misconduct
  - Establish ways for employees to raise concerns, including formal processes for whistleblowing where these are not already in place

# Next steps / FCA expectations

## FCA will:

- Engage with firms to understand results and how they have used data to reflect on culture (focusing on outliers)
- Support trade associations in their efforts to improve standards
- Act where firms fail to adhere to the rules



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**FCA PS24/14 on bond and  
derivative market transparency,  
and the SI regime**

**Rob Moulton**



# Improving transparency for bond and derivatives markets

- FCA PS24/14 published 5 November 2024
- Covers pre- and post-trade reforms for bonds and derivatives, plus FCA materials on the new Systematic Internaliser (SI) definition, and a discussion element on the future of the SI regime
- Most changes will take effect 1 December 2025
- Trading venues will not need to apply pre-trade transparency to voice and RFQ trading from 31 March 2025
- SIs in bonds and derivatives will not need to provide public quotes from 31 March 2025
- Responses on the future of the SI regime due by 10 January 2025; FCA aims to publish a Consultation Paper in the first half of 2025 and implement any resulting changes on 1 December 2025

# Scope of the new regime

	Trading venues	Investment firms
Pre-trade	<p><b>Category 1 and 2</b> Pre-trade transparency applies depending on the characteristics of the market model. Waivers available for LIS orders and Order Management Systems</p> <p><b>Category 1</b> Minimum size of LIS orders set in FCA Handbook</p>	<p><b>Category 1 and 2</b> No obligation</p>
Post-trade	<p><b>Category 1</b> Real-time reporting unless the trade is above the relevant LIS threshold. FCA rules</p>	
	<p><b>Category 2</b> Post-trade transparency set by the trading venue in line with criteria set out in FCA rules</p>	<p><b>Category 2</b> No obligation to report</p>

- **Category 1:** bonds traded on UK trading venues; certain derivatives subject to the clearing obligation
- **Category 2:** emission allowances, Structured Finance Products, other debt securities such as exchange traded commodities and exchange traded notes, and derivatives that are not in Category 1
- FCA has maintained scope as consulted on, but may look at elements of scope in future as part of post-implementation review (including, for example, the transparency of FX derivatives)

# Waivers and deferrals

## Pre-trade transparency and waivers

- FCA proposed to remove pre-trade requirements for voice and RFQ systems, and replace them with a new waiver for negotiated orders
- FCA has modified to remove pre-trade transparency for any system except a continuous auction order book, quote-driven or periodic auction trading system
- As a result, proposed negotiated trade waiver removed
- FCA confirms: no SI-specific pre-trade transparency for bonds/derivative
- FCA has extended the 15-minute deferral for package trades to portfolio trades
- FCA has chosen Model 1 (two LIS thresholds) for reporting bonds and Model 2 (single LIS threshold, with a size cap) for reporting derivatives



# Real-time transparency and calibration of deferrals

## Bonds

- FCA proposed groupings for: (i) sovereign and other public bonds; and (ii) corporate, covered, convertible and other bonds
- FCA has adjusted the grouping criteria for bonds in light of feedback received
- FCA has modified the deferral framework for bonds to have three, instead of two, deferral durations. FCA has also altered the length of those deferrals, and the threshold size for an order to qualify
- In light of feedback, FCA is creating longer deferrals for swaps with non-benchmark tenors and lowering the threshold sizes for SONIA swaps
- FCA is changing deferral model by requiring all trades concluded during a quarter to disclose size of the transaction by the end of the next quarter
- FCA has decided to apply Model 2 to credit default swaps

# Exemptions from post-trade reporting

- FCA proposed to remove certain non-price forming transactions from post-trade transparency
- Changes to exemptions for inter-fund transfers, give-ups and give-ins
- New exemption for inter-affiliate transactions
- FCA proceeding with proposals as consulted on



# Post-trade information

- FCA proposed to add, modify, or delete various fields and flags in post-trade transparency reports
- As part of this, FCA proposed to introduce use of unique product identifier (UPI) codes
- FCA has decided not to require firms to report both the UPI and ISIN for OTC derivatives, but instead will move straight to requiring the reporting of UPI alone where one exists
- Most other changes are being implemented as consulted on, but FCA will reconsider approach as part of the post-implementation review



# SI regime changes

- FCA will go ahead with the change from a qualitative to quantitative definition of an SI
  - Rules and procedures in an automated system
  - Available regularly or continuously
  - Held out as being carried on by way of business
- 1 December 2025 start date (to ease preparations)



# Future of SI regime

- Ongoing changes elsewhere will impact SIs
  - SI (or not) will no longer play a role in determining who trade reports
  - Pre-trade transparency dropped for bonds and derivatives
- Future questions
  - Pre-trade transparency – should SI be dropped altogether?
  - Post-trade transparency – should flags change (as there will be no SINT)?
  - Trading perimeter definition – is it effective?
  - Best execution – is it affected by changes to SIs?



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# The PRA and FCA speeches on international competitiveness and growth

**Nicola Higgs**



# PRA: Competing for growth

The competitiveness and growth objective is about **harnessing the UK's strengths as a global financial centre** by strengthening the following three foundations:

- Maintaining **trust** in the PRA and the UK prudential framework
- Adopting **effective** regulatory processes and engagement
- Adopting a **responsive** approach to UK risks and opportunities

- PRA impacts economic growth mainly by maintaining financial stability
- Largely defensive tone
- PRA takes its new objectives very seriously
- But thinks it is a myth that there are too many (or too few) rules, and that PRA has the balance about right
 

*“I don't see a case for a fundamental re-calibration of the core planks of our regime”*

## FSMA 2023

### S. 25 Competitiveness & Growth Objective

*The competitiveness and growth objective is: facilitating, subject to aligning with relevant international standards—*

- (a) the international competitiveness of the economy of the United Kingdom (including in particular the financial services sector), and*
- (b) its growth in the medium to long term*

### S. 26 Reporting Requirements

*Each regulator must make two reports to the Treasury on how it has complied with its duty to advance the competitiveness and growth objective. Explaining*

- (a) the action taken by the regulator to ensure that the competitiveness and growth objective is embedded in its operations, processes and decision-making, and*
- (b) how any rules and guidance that the regulator has made advance that objective*

# PRA: Competing for growth – remuneration

- Emphasis on scrapping bankers' bonus cap as an “early win”
  - Also “the single most unpopular thing the PRA might ever have done”
  - PRA has always seen this as completely unnecessary, indeed counterproductive, for prudential purposes
  - Made the UK a less attractive location, and gave UK firms overseas a disadvantage
- Preference for deferral
  - UK is an outlier in length of time
  - PRA will reduce deferral periods (from 8 to 5 years for senior managers, and 4 years for others) including allowing vesting on a pro rata basis from year 1

# PRA: Competing for growth – other measures

- Basel 3.1 package governed by competitiveness and growth
  - e.g. lending to: infrastructure; SMEs; trade finance
- Solvency reforms
  - Cut reporting requirements, support insurers making investments
- Smaller banks: strong and simple framework
  - Radical reduction to the burden and complexity of regulation for smaller banks and building societies
  - Alongside efforts to make the retail ringfence regimes work more efficiently for larger banks
- Simplify administrative aspects of senior managers regime

# FCA: Growth – mission possible

- Much more on the front foot, and accepting FCA's limitations
- “We recognise that the jury is out on whether the FCA is helping to achieve growth...we clearly have more to do”
- Open a research competition (?) to find the missing answers (?) on how the FCA can support capital formation, productivity gains, and financial services exports





# FCA: Growth – mission possible (other issues)

- Enforcement
  - Clearly going to go ahead with proposals, with some tinkering
  - “Our current approach doesn’t work. We think and agree more openness can reduce harm”
  - The FCA will publish more data and case studies on how a public interest test would work in practice
  - It won’t by default be when an investigation starts
  - The FCA will give firms of all sizes longer to make representations about impacts
  - “Our board will decide next year”

# FCA: Growth – mission possible (other issues)

- Investment research
  - “Government or regulatory action is not always needed. Rachel Kent recommended an investment research hub that requires neither. Just industry funding and leadership”
- Capital markets
  - “Our far-reaching listing reforms are already being used. More radical reforms on prospectuses are readying for take-off”
- Investing in capital
  - “We are a nation of improving savers, but bad investors”

# Recent Thought Leadership

- [FCA Publishes Results of Non-Financial Misconduct Survey](#)
- [UK Regulators Set Out Plans on Growth and International Competitiveness](#)



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## Monthly London Webcast Materials

Each month the UK and European Financial Regulatory lawyers at Latham & Watkins host a presentation and discussion covering recent changes to financial services regulation.

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