Financial Regulation Monthly Breakfast Webcast

11 December 2024

LATHAM&WATKINS

Today's Topics

An overview of the financial services aspects of the Chancellor's Mansion House speech	Rob Moulton
The latest on MAR, including FCA's PMB52	Jonathan Ritson-Candler
An update on the UK's approach to the ESG agenda, including ESG ratings	Nicola Higgs
An enforcement update, including FCA's climbdown on its approach to early publicity	Nell Perks

An overview of the financial services aspects of the Chancellor’s Mansion House speech

Rob Moulton

Introduction (vibes)

- Overt focus on overall growth and competitiveness, and taking risks
- New remit letters for FCA / PRA reinforce this point
  - FCA response 9 December emphasised the challenge for FCA
  - Encouraging risk-taking when there is still a lack of “consensus with Government and across Parliament” and a reminder that “no other comparable regulator is liable for losses in the way some argue we…should be”.
- Financial services is “the crown jewel in our economy”
- Importance of improving ties with both US and EU
- Announced Financial Services Growth and Competitiveness Strategy is due Spring 2025
  - Fintech; sustainable finance; asset management and wholesale services; insurance and reinsurance; capital markets
- Post financial crisis, regulatory changes have “gone too far”…
- …but very few deregulatory announcements are included in the speech

SMCR

- No detailed announcements so far
- Discussion is on the replacement of the certification regime
  - Remove annual recertification requirement?
- Linked to expected announcements on SMF7 (overseas group senior manager)

PISCES

- Draft legislation published 14 November 2024
  - Technical comments invited by 9 January 2025
- PISCES will be open to a wider range of investors
  - Employees; investors who are high net worth or sophisticated under the FPO
- Tailored disclosure regime based on due diligence approach in private markets
  - Negligence standard for most disclosures
  - Recklessness standard for forward-looking information
- MAR entirely disapplied for PISCES
  - Therefore no transaction reporting either
- Shares traded on PISCES exempt from stamp duty and Stamp Duty Reserve Tax

Financial Ombudsman Service

- Seeks feedback on whether current FOS structure is fit for purpose
- Call for input (open until 30 January 2025) focus is on:
  - Mass redress events
  - Role played by claims management companies

Advice Guidance Boundary Review

- December 2023 – launch of original consultation
- 15 November 2024 – update on approach
  - First consultation (December 2024) will focus on pensions support
  - Further policy proposals to be developed H1 2025 on wider consumer investments and services markets
  - Link to (still ongoing) work on the new Consumer Composite Investments (to replace PRIIPs and UCITS disclosures)

MiFID transaction reporting – scope

- Extend regime to capture AIFMs and UCITS managers
- Simplify the type of instrument that must be reported because an underlying is traded on a trading venue
- Drop the use of dated ISIN for OTC derivatives by either modifying it (to exclude the expiry date) or using a UPI instead
- Remove the requirement for SIs to submit instrument reference data
- Permit UK firms (and UK branches) to act as a receiving firm for non-MiFID investment firms
- Require UK trading venues to report all transactions by third country investment firms (irrespective of UK branch involvement)

MiFID transaction reporting – content

- Allow firms to report the underlying beneficiary of a trust whether or not they helped establish it
- Require only the segment MIC of a trading venue (rather than that of the CCP) to be reported where a counterparty is not known at the point of execution
- Make changes to the “transmission of order” indicator (confusion through dual use of AOTC and “true”)
- New guidance on the quantity and price type fields for equity swaps (nine different approaches currently taken)
- Remove following indicator fields: waiver; short selling; OTC post-trade; commodity derivatives; securities financing
- Add aggregate client linking code (to improve on INTC)
- Add client category field (retail, professional etc.)
- Create new DEA indicator
- Extend obligation to report full name and date of birth from not only buyer and seller fields, to also investment and execution decision-maker fields

MiFID Org Reg

- MiFID Org Reg will form part of FCA Handbook (to make it easier to amend)
- FCA Call for Input had already announced potential to harmonise and streamline rules
- Mooted areas for reform include:
  - Conflict of interest rules
  - Market Conduct Sourcebook (depending upon repeal and restatement of UK MAR)
  - Best execution and personal account dealing
  - Client categorisation (and link to corporate finance contact definition)
  - Article 3 MiFID optional exemption firms (often personal investment firms or corporate finance firms), where underlying rules may differ such as client categorisation, telephone taping, record keeping

Remuneration

- Follow on paper (to removal of the bonus cap last year)
- PRA says rules for identifying MRTs are “not specifically tailored for the UK market”
- Proposal is to create a single quantitative threshold (0.3% of highest earners)
  - This will be in the Supervisory Statement on Remuneration, meaning it is an expectation (that can be overruled with CRO approval)
  - Although PRA also proposing a new rule that CRO annually review the MRT methodology
- Reinstate proportionality threshold to disapply rules such as deferral
  - Provided total remuneration does not exceed £660k, and variable is not more than 33%
  - Delete “higher paid material risk taker” and “significant firm” definitions
- PRA will raise the variable remuneration threshold at which at least 60% must be deferred from £500k to £660k

Remuneration (cont.)

- PRA proposes simplified two-tier deferral framework
  - Reduce from 7 to 5 years the deferral period for certain Senior Managers (and 4 years for others)
  - Vesting can start from time of award
- PRA proposes new rule and guidance on varying renumeration where an MRT could be held responsible
  - Also adding a rule and guidance requiring material or urgent actions requested by PRA in a Periodic Summary Meeting to form part of a manager's Statement of Responsibilities
- FCA will change its rules to mirror PRA's rules for dual regulated firms
  - But no change for solo regulated (which may lead to the perverse situation of solo regulated firms being subject to stricter rules)
- Responses requested by 13 March 2025
  - Policy Statement H2 2025 with amendments to come into effect immediately, and application from the start of the next performance year

The latest on MAR, including FCA's PMB52

Jonathan Ritson-Candler

PMB 52

- On 15 November 2024, the FCA published Primary Market Bulletin 52, which focuses on:
  - Instances where the FCA observes issuers may grapple with identifying inside information and when to disclose
  - Controls around the disclosure of inside information during calls with shareholders
  - The dissemination of inside information via Primary Information Providers (PIPs) and what to do in the case of outages

Identifying inside information

	Risks	Mitigants
Offer processes	• The FCA highlighted a case where advice was provided that inside information crystalised only when a final offer was accepted by the company's directors (as it was not certain enough prior to that point to be "precise") • The FCA disagrees – cites Hannam, that the threshold for precision is lower than "more likely than not" (but more than "fanciful") and it is possible that "receipt of an offer could be inside information before it has been formally considered" • Factors that might be taken into account: identity of the bidder; nature and quantum of the offer; and likelihood the offer will be recommended	• Establish a disclosure committee to advise and determine, which has a clear understanding of the definition of inside information, and access to external advice (including legal) • Ensure CFO, CEO and CoSec can make announcements outside normal reporting timetables and absent a formal disclosure committee meeting occurring • Training relevant employees (especially finance) by rehearsing scenarios to recognise inside information • Ensuring the timely creation and updating of insider lists • Documenting reasoning behind classification
Periodic financial information	• FCA aware of cases where finance packs showed revenues did not meet internal forecasts, were below consensus, but were not announced on the basis that the below-forecast performance will be compensated by over-performance later in the year • When over-performance has not occurred, subsequent publication has led to (in one example) 50% share price fall • Issuers should instead be disclosing, in particular where previously stated financial objectives or targets may not be met. Offsetting negative and positive news is not acceptable	
Changes to the CEO	• FCA aware of cases where there is press speculation on a CEO departure • Companies must identify inside information relating to departures and (where required) disclose it – especially when information leaks • Process for recruiting a successor has a long lead time, but assessment of inside information (or not) should be carried out "continuously and on a case-by-case basis" • Separate assessments for: resignation; and appointment (two separate pieces of information) • Reminder to take care to control inside information (wall cross?) external search consultancies	

Disclosure during shareholder calls and meetings

- Potential issues:
  - Regular engagement between issuer and shareholder is a key principle of good corporate governance
  - FCA aware some issuers use WhatsApp groups, or private calls, with small groups of shareholders
  - Creates a risk that confidential, non-public or price sensitive information is shared (or misunderstood)
  - Reminder of the Gent fine
  - Necessity for use of “clear and unambiguous” language to be understood by investors
- Mitigants:
  - Issuers could avoid scheduling calls or making communications during closed periods
  - Communications could take place shortly after publication of financial information
  - Management should be confident all inside information has been published before embarking on a call
  - Issuer may publish an announcement that a call took place and what information was discussed

PIP outages

- Following the issues caused by the CrowdStrike outage in July 2024, the FCA observed issuers publishing information on their websites without checking if it had been disseminated via the PIP
- Issue being that if made only via the website, owing to IT difficulties with PIPs, the information had not, in fact, been made public via an RNS
- FCA reminds firms that the obligations in DTR 1.3.6G to disseminate regulated information are with the issuer (not the PIP)
- Suggests firms should have a second PIP account as a backup

IOSCO pre-hedging consultation report

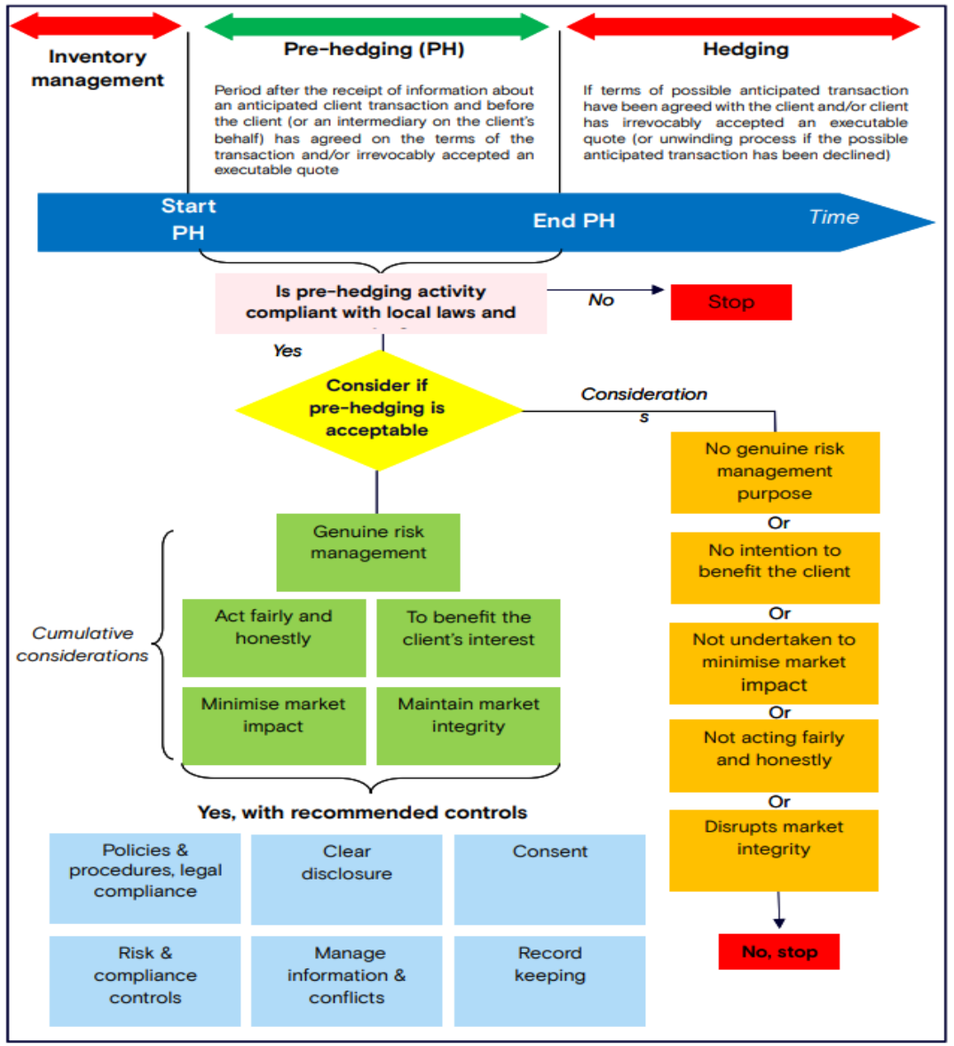
- On 21 November 2024, published a consultation paper that:
  - Proposes a definition of pre-hedging
  - Sets out guidance for when pre-hedging may be acceptable
- IOSCO acknowledges a disparate approach between securities regulators and the lack of a uniform approach
- Period for comments closes 21 February 2025
- IOSCO aims to issue a final report “in 2025” which will confirm a definition of pre-hedging and recommendations as guidance that IOSCO members should consider implementing in their jurisdictions
- Meaning this consultation is not intended to result in a final report which will apply to regulated firms; rather, it initiates further engagement by local regulators (such as ESMA and FCA)
- Flags there is no globally consistent approach
  - Including between asset classes

IOSCO pre-hedging consultation report (cont.)

Proposes following definition:

- Trading undertaken by a dealer, in compliance with applicable laws and rules, including those governing frontrunning, trading on material non-public information / insider dealing, and/or manipulative trading: where:
  - (i) the dealer is dealing on its own account in a principal capacity;
  - (ii) the trades are executed after the receipt of information about an anticipated client transaction and before the client (or an intermediary on the client's behalf) has agreed on the terms of the transaction and/or irrevocably accepted an executable quote; and
  - (iii) the trades are executed to manage the risk related to the anticipated client transaction

Utilises the following schematic:



Conditions for pre-hedging

- This results in “cumulative conditions” which must be satisfied in order to legitimately pre-hedge:
  - Dealers should only pre-hedge for a “genuine risk management purpose”:
    - Need a legitimate expectation of a client transaction (case by case assessment)
    - Where a dealer reasonably assess there may not be sufficient liquidity to manage their exposure if they execute in line with the anticipated transaction
    - In light of relevant market conditions
    - In a way which is proportionate (e.g., size and amount of pre-hedging versus hedging that can be done following receipt of irrevocable order)
  - Acting fairly and honestly – i.e., compliance with existing market abuse laws (no frontrunning)
  - To benefit the client – in line with the firm’s best execution obligations and client’s attitude to pre-hedging (albeit not intended to oblige dealers to share all financial benefits with the client – implies some?)
  - Minimising market impact – being aware that clients requesting quotes from multiple dealers who pre-hedge, may cause price slippage, thereby disadvantaging themselves
  - Maintaining market integrity

Controls around pre-hedging

- In addition, IOSCO suggests a range of conduct risk management measures:
  - Policies and procedures to manage conflicts and market abuse concerns
  - Disclosure to clients of pre-hedging practices and policies
  - Consent from clients to pre-hedging activity
    - Paper requests feedback whether this should be baked into terms of business upfront
    - Potential for clients to withdraw consent
    - Trade by trade?
    - Post-trade analysis
  - Second and third line supervisory review
  - Information barriers to manage frontrunning risk
    - Trader taken off trading floor to work in separate dark room

An update on the UK's approach to the ESG agenda, including ESG ratings

Nicola Higgs

ESG: What can we expect from HMT in 2025?

- Climate disclosure: roll-out of mandatory TCFD-aligned disclosures across the whole economy
- Transition plans:
  - H1 2025: HMT to consult on how best to implement requirements in relation to transition plans
- Sustainability disclosure:
  - H1 2025: HMT to consult on sustainability disclosure requirements against UK Sustainability Reporting Standards (SRS) – 'UK ISSB'
- UK Green Taxonomy:
  - 14 November 2024: HMT launched a consultation on the value case for a UK Green Taxonomy

ESG Ratings

- 14 November 2024: HMT published near-final legislative text for ESG ratings
- Key policy objective of the UK government is to capture ESG ratings which are 'likely to influence' a decision to make an RAO-specified investment
- New regulated activity: providing ESG ratings
  - UK firms: providing ESG ratings to UK and non-UK users by any means – this applies whether provided by way of a business relationship (paid for by the user, either on its own or as part of another service or bundle of products), or provided for free to users
  - Overseas firms: providing ESG ratings to UK users by way of a business relationship (paid for by the user in the UK, either on its own or as part of another service or bundle of products)

ESG Ratings (cont.)

- Exclusions
  - Regulated products and services
  - Ancillary non-commercial provision
  - Ratings for internal use
  - Bespoke/private ratings
- Timing
  - FCA consultation next year on the regulatory regime for ESG ratings providers
  - UK – anticipated for 2029 entry into force
  - EU – anticipated mid-2026 entry into force

SDR

- 2025 will continue to see the phased implementation of the SDR regime:
  - Q2 2025: FCA is expected to publish final rules on the extension of the SDR rules to portfolio managers
  - April 2025: Firms relying on the FCA's temporary extension for complying with the naming & marketing rules must fully comply
  - H2 2025: It is anticipated that SDR will apply to the overseas funds regime (subject to FCA consultation)
  - 2 December 2025: Ongoing product- and entity-level disclosures for firms with AUM >£50bn take effect

An enforcement update, including FCA's climbdown on its approach to early publicity

Nell Perks

Transparency of enforcement investigations

“Effective enforcement work reinforces the UK’s reputation as a trusted, clean and stable place to do business.”

Four changes to proposals made in February 2024:

- Firm impact
- Notice period
- Market ramifications
- Ongoing investigations

Approach

1. Focus
   - Change in enforcement portfolio
   - Raised the bar for opening an investigation
   - Annual reporting on number of cases where no further action taken following investigation announcement
2. Pace
   - 2023/2024 – average of 42 months to complete
   - Recent examples – 13 to 15 months

Approach (cont.)

3. Transparency
   - Analysis of open investigations
     - 15 not in public domain or likely to reach a public outcome by mid-2025:
       - 6 – not in public interest to announce
       - 2 – may be public interest factors in favour of announcing on anonymised basis
       - 7 – may be public interest factors in favour of announcing on named basis
   - Analysis of 15 investigations opened between April 2023 and November 2024:
     - 1 – announced under existing policy
     - 4 – may be in public interest to announce and name
     - 5 – made public, not by the FCA
   - Small and incremental?

Approach (cont.)

- How the proposals might work in practice
  - Would any announcement of the investigation be in the public interest?
  - When might an announcement be made?
  - What might be announced?
    - Factors in favour of / mitigating against naming
- Time to respond
- Safeguards
- When might the FCA announce but not name the firm?
- Next steps

Other enforcement issues/trends

- Streamlining caseload of investigations
- Prioritising reduction and prevention of financial crime
- Increased use of section 166
- Arian Financial LLP v FCA

Recent Thought Leadership

- Key Takeaways From Rachel Reeves' Mansion House Speech
- It's in the Stars — HM Treasury Recasts and Pushes Forward PISCES
- UK Regulators Propose Shake-up to Bank Remuneration Rules
- FCA Issues Discussion Paper on Changes to the UK Transaction Reporting Regime
- ESG Ratings: UK Confirms Regulatory Regime
- FCA Publishes Revised Proposals for Announcing Enforcement Investigations
- UK Regulators Publish Final Rules for Critical Third Parties
- Regulators Publish Third UK Financial Services Artificial Intelligence Survey

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.

VIEW

The Edinburgh Reforms — Two Years On

We assess which of the measures have been completed, which remain outstanding, and whether they have delivered on the agenda set out.

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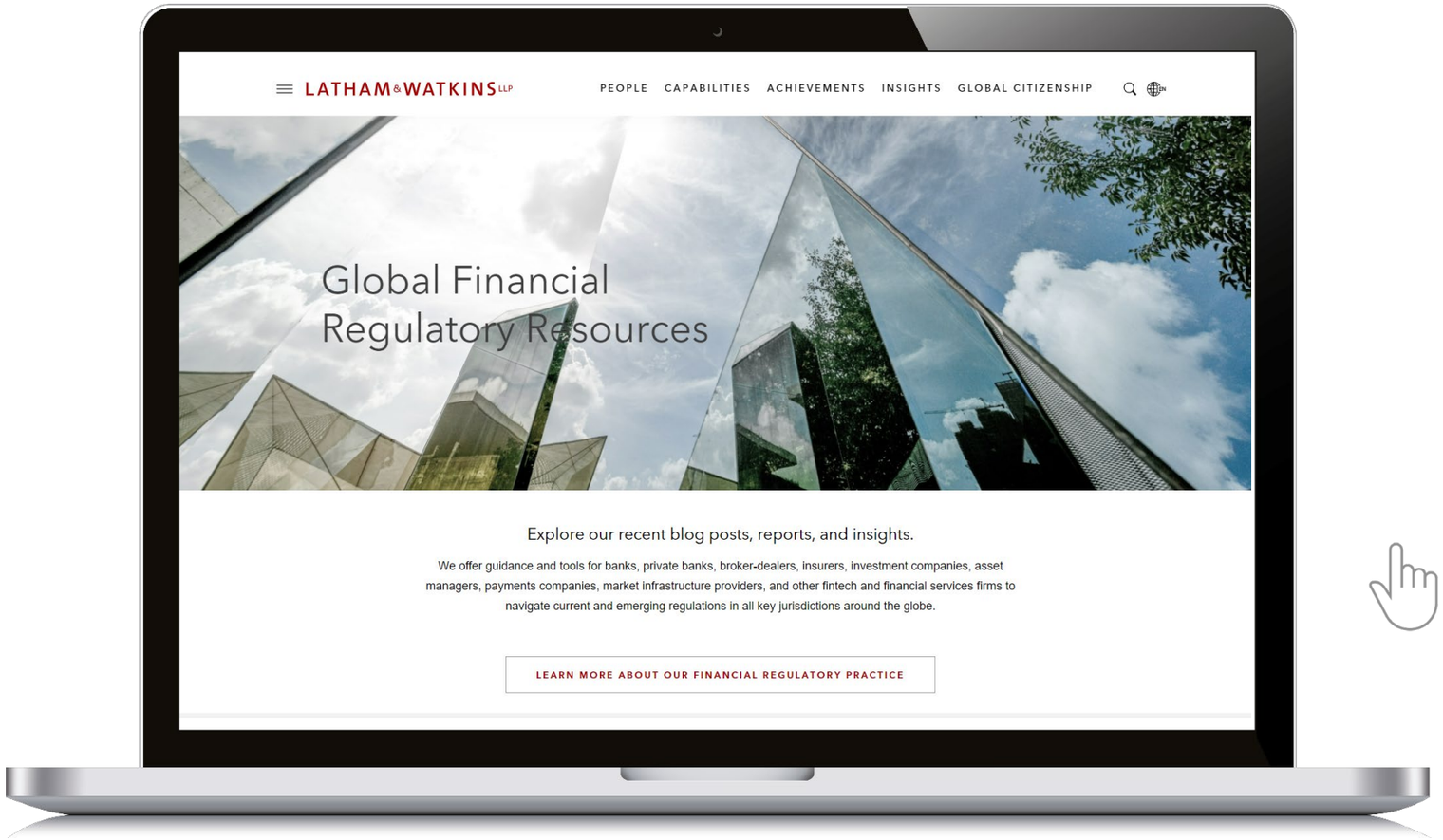

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