

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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20 April 2022

Financial Regulation Monthly Breakfast Seminar

Overview



A blue-toned background featuring a financial line chart with a grid. The chart shows two data series: a solid blue line and a dotted blue line. The solid line starts high on the left, dips, rises, dips again, and then rises sharply to a peak on the right before falling. The dotted line starts high, dips, and then falls steadily from the center towards the right. The overall aesthetic is professional and data-oriented.

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FCA's release of new PRIIPs rules targeting areas of
harm to investors
Nicola Higgs

FCA Final Rules on PRIIPs

- The rules apply from 25 March 2022 but firms have until 31 Dec 2022 to consider how to implement them
- **Scope**
 - FX forwards & FX swaps are in scope
 - REITs – case by case assessment required
 - Listed Investment Companies – retail AIFs are PRIIPs (notwithstanding being a body corporate)
 - SPACs – not PRIIPs when publicly listed (investors can swap for shares in the SPAC company or redeem). Manufacturers need to consider the features of pre-listed SPACs separately

FCA Final Rules on PRIIPs

- “Made available”
 - A financial instrument is not made available to retail where the following (cumulative) conditions are met:
 - Marketing materials highlight the investment is for professionals only;
 - Issuer / Distributor takes reasonable steps to limit the marketing / distribution per the above; and
 - A minimum denomination of £100K applies to the investment

FCA Final Rules on PRIIPs

- Confirms amendments to the RTS to:
 - Replace the requirements and methodologies for presentation of performance scenarios in the KID with a requirement for narrative information on performance to be provided
 - Address the potential for some PRIIPs to be assigned an inappropriately low summary risk indicator in the KID - require manufacturers to upgrade a product's SRI score when the score resulting from the application of the RTS methodology underestimates the level of risk
 - Address concerns about certain applications of the 'slippage' methodology when calculating transaction costs

FCA Final Rules on PRIIPs

- Debt instruments – Clarifications
 - FCA has confirmed the existing position that a **sovereign bond** is not a PRIIP
 - It has flagged **regulated covered bonds** and **sukuks** as instruments requiring PRIIPs analysis on a case by case basis

FCA Final Rules on PRIPs

- A **new rule** located in the DISC confirms
 1. A **debt instrument is a PRIP where**: the level of interest payable, any conditionality of principal repayment, or the issuer's default risk, is linked to or materially dependent on the following (whether or not modified by a pre-determined formula):
 - Fluctuations in reference indices or benchmarks relating to investment assets or a class of investment assets, for example a stock market index;
 - *Excluded: BofE base rate; any benchmarks or indices tracking the rate of inflation, money market interest rates, or other indicators pertaining to the performance of the general economy*
 - The value or performance of reference investment assets, such as a basket of shares or specified commodities; or
 - The value or performance of investments held by the issuer (or by a person connected to the issuer)
 - *Investments: derivatives, real estate holdings, a pool of receivables, or a portfolio of securities; and*
 - *Person connected to the issuer: member of the same group as the issuer, has a relevant business relationship with the issuer, or otherwise does not have an arm's-length relationship with the issuer*

FCA Final Rules on PRIPs

2. A debt instrument is not a PRIP where:

- The features on the previous slide are not present;
- The issuer's default risk is wholly or predominantly determined by the economic performance of the commercial or industrial activities of the issuer (or, where the debt security is guaranteed by a group person, that person); **and**
 - *Note: lending, investment, and any other financial sector activities are not commercial or industrial activities*

FCA Final Rules on PRIPs

2. A debt instrument is not a PRIP where:

- The terms of the debt security do not impose any modification, structuring, or conditionality on the issuer's obligation to pay interest or repay the principal save for the following **neutral features**:

<p>Fixed coupon rate, including where:</p> <p>(a) a set coupon rate applies until maturity, including a nil or zero rate; and</p> <p>(b) the coupon rate is subject to pre-defined changes at fixed times prior to maturity (a stepped coupon)</p>	<p>Put option giving the investor a discretion to demand early repayment of the debt security on pre-agreed terms, or giving the investor the choice to convert or exchange their debt security into one or more shares of the same issuer at a pre-determined price</p>
<p>Floating or variable coupon, provided that:</p> <p>(a) the interest payable is determined by an index or benchmark of the permitted kind, with or without a spread reflecting the credit risk of the issuer; and</p> <p>(b) the interest payable is not subject to any additional modification or structuring such as, for example, a cap, or a floor other than zero</p>	<p>Call option allowing the issuer to redeem a debt security early at a price higher than or equal to par, where:</p> <p>(a) the option becomes exercisable due to changes in the financial health, market confidence in, or control of, the issuer, or general economic conditions, but not including options exercisable in response to fluctuations, price movements or performance of an index, benchmark, specified asset or underlying asset falling within the features on the previous slide; and</p> <p>(b) the mechanism to calculate the net present value of the future coupon payments is made clear to the investor in the terms of the debt security</p>
<p>Perpetual or indefinite term</p>	
<p>The debt security's subordination in the creditor hierarchy in the event of the issuer's insolvency</p>	

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Highlights from the FCA's 2022/23 Business Plan
Jonathan Ritson-Candler

FCA affirms its plans for 2022/23

- FCA reiterates that it will deliver its 2022 to 2025 strategy by breaking this down into, and carrying out work under, 13 commitments
- These commitments are grouped into three overarching categories:
 - Reducing and preventing serious harm
 - Setting and testing higher standards
 - Promoting competition and positive change
- The FCA's budget for 2022/23 is £640m, up from an actual spend of £613m in 2021/22
 - Greatest areas of increase: scope (FCA anticipating its increased scope driving higher costs) and the ongoing regulatory activity budget
 - Brexit spend reduced to zero (down from £10m last year)

4 macro themes for how the FCA will deliver on its strategy

- Outside of the commitment structure, the FCA specified four workstreams necessary to deliver on its strategy
 1. Becoming a data-led regulator: FCA is building analytical tools to identify risks (such as phoenixing firms) which the FCA can address through “frontline” teams or automated interventions. FCA is investing in machine learning and AI
 2. Regulatory decisions: certain decision making moved to the FCA to free up the RDC to focus on contentious enforcement cases
 3. Diversity and inclusion: FCA updates on its own D&I work and status against its targets:
 - Currently 47% of senior leadership team (SLT) identifies as female (target is 50% by 2025)
 - 15% of SLT identifies as being from an ethnic minority (target is 20% by 2025)
 4. Crypto: stablecoins being brought within perimeter, continued focus on AML and CTF compliance and financial promotions for other crypto firms

Reducing and preventing serious harm

- Dealing with problem firms
 - FCA expects to increase cancellations or withdrawals of firms' licenses over the next 3 years (more active policing of firms' continued meeting of the Threshold Conditions)
 - FCA will identify non-compliant firms "at pace and at scale" (may use automated approach + new hires)
 - FCA wishes to increase the awareness of, and perceived effectiveness of, FCA interventions (note use of term "perception metric" used in a number of places throughout the Business Plan)
- Improve redress framework
 - Look to measure fairness of complaint resolutions rather than simply timeliness of resolutions
 - Engage in an active campaign to increase consumer awareness of redress system

Reducing and preventing serious harm

- Reducing harm from firm failure
 - FCA is looking to be “more assertive” with its powers to start insolvency processes when necessary to mitigate harm
 - Increased focus on firms’ orderly wind down procedures
- Improved oversight of Appointed Representatives (and principal firms)
 - Current consultation underway reviewing principals’ responsibilities and FCA’s expectations of principals
 - FCA will strengthen scrutiny of principal firms at authorisation stage and also as they engage ARs
 - Increased supervision of high-risk principals including greater use of enforcement powers

Reducing and preventing serious harm

- Reducing and preventing financial crime
 - Real end to end focus on “fraudulent schemes” i.e., from misleading or unlawfully made financial promotions through to greater focus on firms’ anti-fraud systems and controls (and the FCA’s ability to monitor)
 - FCA will closely supervise cryptoasset firms’ compliance with the MLRs including stating that it will reject, withdraw or refuse a greater number of registration applications that fall short of required standards
- Delivering assertive action on market abuse
 - FCA keen to increase confidence in the integrity of the UK’s primary and secondary markets and maintaining high levels of buy and sell side participation on those markets
 - FCA will increase the number of FCA interventions for market abuse (in particular, for issuers that fail to make proper disclosures of inside information)
 - Increasing detection capability

Setting and testing higher standards

- Putting consumers' needs first
 - FCA's continued concerns that consumers are being sold products and services that do not meet their needs or are priced such that their value is diminished
 - Helpful prompt for firms to re-assess the effectiveness of their product governance frameworks
 - FCA is looking to tackle this by way of the implementation of the Consumer Duty and the expectation that both the FCA and firms will embed this at "every stage of the regulatory lifecycle" (from authorisation to ongoing supervision to enforcement)
- Enabling consumers to help themselves
 - The FCA's recent renewed focus on the financial promotions regime (and driving up compliance standards as well as specifying new rules for high risk investments and bringing cryptoassets in scope) sits under this commitment
 - Regulatory gateway for firms approving unregulated firms' financial promotions

Promoting competition and positive change

- Preparing financial services for the future
 - FCA reiterates its continued focus on ensuring the regulatory framework is fit for purpose post-Brexit and provides the best framework for UK markets
 - FCA will continue to work with HMT to design and deliver a new UK regulatory framework
- Strengthening the UK's position in global wholesale markets
 - FCA will enhance its capacity to approved listed issuers onto UK capital markets
 - Transfer of regulatory framework from legislation into FCA rules
 - Develop a way to measure market participants' perception of UK markets



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FCA's observations on wind-down planning
Rob Moulton

Scope

- “We encourage all firms to review the Wind-Down Planning Guidance (WDPG) section of the FCA Handbook and FG20/1, in addition to the specific points raised in this paper”
- Groups – wind-down planning can be undertaken as a Group, so long as it also adequately covers each individual entity
- Also consider the impact of (and on) non-regulated entities

Wind-downs

- “During wind-down a firm must continue to pay its liabilities as they fall due, as a failure to do so could push the firm into a disorderly wind-down or an insolvency process”
- The FCA encourages “many” firms to hold a pool of liquidity specifically to fund wind-down
 - Ring-fence that liquidity
 - Ensure segregated funds can only be used following Board approval
 - Ensure segregated account not subject to set-off rights

Wind-downs

- “Investment Brokers may be responsible for funding temporary mismatches arising from facilitating the end of clients’ trading activity, where there may be several days gap between the timing of funds paid out to clients and those received from exchanges or counterparties”
 - Consider likely withdrawal of overdraft and other financing facilities
- Firms’ planning assumed entering wind-down with current cash balance
 - Need to consider starting in stressed position
 - Use of Fixed Overhead Requirement is too simplistic a proxy

Intragroup dependencies

- A common failure is not considering interconnectivity, such as parental failure
 - Impact on Group HR and IT functions
 - Assumption contracts could be novated is “unlikely to be credible”
- Use of Group ServCo can help mitigate interconnectivity concerns
- Importance of independent and adequately skilled governance of UK entities

Wind-down triggers

- Should be closely linked to risk management framework
 - Common criticism is that wind-down triggers are not linked to BAU risk appetite
- Use of forward-looking triggers is recommended (cash forecasts, operational capabilities, etc.)
- “If the firm needs £5 million of cash to complete its wind-down, the firm should consider winding-down once it reaches that cash threshold”

Worked example – Investment Brokers

- Appendix covers “Investment Brokers”
 - Suggests possibility of “sale of exchange memberships and seats”
 - Wind-down costs and operational expenses become unpredictable (advisory fees)
- Firms in wind-down “tend not to be net cash accretive...due to a reduction in client activity”

The background of the slide is a blue-tinted financial line chart. It features a grid of dashed lines and several data series represented by solid blue lines of varying thickness. The lines show fluctuating trends, with some showing a general downward slope and others showing more volatility. The overall aesthetic is professional and data-oriented.

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An update and insights on SMCR
David Berman

An Update and Insights on SMCR

- Many firms are taking stock
- What (if anything) should be deduced from the number of SMCR-related enforcement sanctions?
- Some particularly tricky areas:
 - Interplay between Conduct Rule breaches and F&P regime
 - Documentation
 - Consistency of narrative – across Form C, regulatory reference and messaging to employee
 - Relevance of non-financial misconduct to F&P and Conduct Rules – where to draw the line?
 - Culture lens overlay
 - Failure to address
 - Striking an appropriate balance between regulatory obligations and employee fairness

An Update and Insights on SMCR

- Awareness of implications of conduct rules breaches – more to be done?
- Multiple (potentially overlapping) notification obligations to consider
- Reasonable steps risk assessments – time to revisit?

Webcast Series: SMCR Revisited



REGISTER

MONDAY

25 April 2022

9 May 2022

23 May 2022

12:30 – 1:15 p.m. BST

Monday 25 April 2022

Conduct Rules, Fitness and Propriety, and Disciplinary

- Recap on the fitness and propriety standards and expectations
- Consider the interplay with Conduct Rules and breach notification obligations
- Reconciling employment law and regulatory considerations
- Highlight common practical issues and insights

Monday 9 May 2022

Regulatory References and Terminations

- Recap on the fundamentals of the regulatory references regime
- Address some of the thorny practical issues that can arise in the context of preparing and updating a regulatory reference
- Striking the right balance between firm and employee interests

Monday 23 May 2022

Reasonable Steps

- A brief recap of the avenues of personal exposure under SMCR
- Focus on what 'reasonable steps' might look like in practice
- Highlight various practical pointers, case studies, 'war stories', and industry insights

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[FCA's 2022/23 Business Plan: Key Highlights](#)

[New Report Reviews Impact of UK Payments Regulation](#)

[ISSB Publishes Long-Awaited Exposure Drafts of Global Sustainability Standards](#)

