

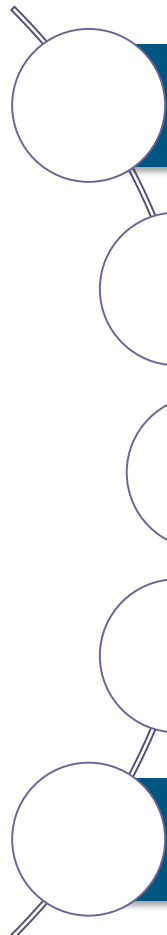
A blue-toned background image featuring a financial line chart with multiple data series and a grid. The chart shows various trends, including a sharp decline followed by a recovery and another decline.

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8 December 2021

Financial Regulation Monthly Breakfast Seminar

Overview

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- Further FCA consultation on new Consumer Duty
 - IFPR – key considerations and timings for 2022, including those from FCA’s final Policy Statement
 - FCA Market Watch 68 on web-based trading platforms
 - The EU’s proposals for revisions to the MiFID II framework
 - The confirmed changes to the UK MiFID rules on research and best execution

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Further FCA consultation on new Consumer Duty
Rob Moulton

Consumer Duty – overview

- Long list of past issues (addressed – of course – by the existing rules)
 - High-cost credit review
 - MiFID II product governance in asset management firms
 - Contracts for differences
 - SIPP operations (etc.)
- FCA thinks that the new Consumer Duty is
 - A major upgrade on existing protections
 - Will be “both appropriate for the environment in which consumers currently transact and for those in which they will transact in the future”
 - Will be pro-competitive, creating “innovation in pursuit of good customer outcomes”

Consumer Duty – in detail

- A “positive obligation on a person to ensure that their conduct towards others meets a set standard”
- FCA does not “expect firms to protect their customers from risks they understood and accepted” if they “have the information and support they need to be able to make informed decisions”
- Scope is broader than “Retail Client” – will follow sectoral handbooks (ICOB, MCOB, COBS)

Application along distribution chain

- “All firms that have an impact on consumer outcomes will need to consider their obligations”
- “Our proposed rules would apply proportionately, taking into account the firm’s role”
- Structured products given as an example – “an investment bank that designs a structured product for sale to retail customers would be subject to the Consumer Duty but investment banks providing wholesale instruments as component parts of a product created by a third-party firm would not”
- Does not apply to primary market activities for non-complex and non-retail instruments
- Application to distribution chain effectively replicates PROD for all other regulated instruments that involve Consumers

Existing products and services

- No retrospective application...
- ...but applies to existing products or services which are still being sold, or are closed products or services that are not being sold or renewed
- Recognition of need to avoid unnecessary changes to existing contracts

Interaction with existing requirements

- Consumer Duty creates a “higher standard of conduct than Principles 6 and 7”
- Consumer Duty does not create a new fiduciary duty
- Approach to assessing customer impacts requires integration with Operational Resilience approach
- SMCR – conduct rules amended for those interacting with Consumers

Implementation points

- Intended to be in force 30 April 2023
- Not intended to give right to a Private Right Of Action
- Ongoing consultation process until 15 February 2022
- Final rules due 31 July 2022



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IFPR – key considerations and timings for 2022,
including those from FCA’s final Policy Statement

Rob Moulton

FCA PS21/17

- Final Policy Statement on the IFPR
- All rules are now finalised – can be viewed in the FCA Handbook via the time travel facility
- PS21/17 covers miscellaneous topics, including:
 - Disclosures
 - Applications and notifications
 - The approach to onshored CRR technical standards relevant to the IFPR
 - The FCA's approach to enforcement
 - Consequential changes to the Handbook

Key timings

2021	2022		
<p>1 December Advance data collection starts for K-factor requirements</p>	<p>1 January IFPR comes into force</p> <p>Deadline for non-CRR firms to notify FCA of the eligibility of their pre-MIFIDPRU capital to be treated as own funds under MIFIDPRU 3</p> <p>Deadline for non-SNI firms to have MiFIDPRU compliant remuneration, risk and nomination committees in place</p>	<p>Mid-January Firm reporting schedule will be updated based on IFPR set-up questionnaire</p>	<p>1 February Deadline for existing CRR firms and their parents holding AT1 capital instruments to notify FCA of their intended use of those existing capital instruments under MIFIDPRU</p> <p>Deadline for applications by firms wishing to apply the group capital test on a temporary basis</p>
<p>First ICARA reference date</p> <p>First IFPR disclosures due for some firms (except on risk management objectives and policies, investment policy, and remuneration), depending on the firm's financial year end</p> <p>Remuneration requirements apply from start of first performance year from 1 January 2022</p> <p>Submit existing prudential returns that cover the reporting period up to and including 31 December 2021</p> <p>Transitional period for capital requirements</p>			

Key timings

2023	2024	2025	2026
<p>First MIFIDPRU remuneration disclosures likely to be due for most firms (assuming annual performance period)</p> <p>First IFPR disclosures on risk management objectives and policies, and on investment policy due (following first full year under IFPR)</p>	<p>1 January Temporary use of group capital test expires (or earlier if specified by the FCA)</p>		<p>31 December End of transitional period for capital requirements</p>
<p>End of year All firms must have submitted their first MIF007 (for firms with a current ICG or ILG this needs to be by the end of March 2023)</p>			
<p>Transitional period for capital requirements</p>			

Capital

- Own funds requirement is the highest of:
 - Permanent minimum capital requirement - £75,000, £150,000 or £750,000 (depending on the firm's activities)
 - Fixed overheads requirement (minimum amount of capital that a firm would need available to absorb losses if it has cause to wind-down or exit the market) - one quarter of the firm's relevant expenditure during the preceding year
 - K-factor requirement (non-SNI firms) - sum of all of the K-factor requirements that apply to the firm
- Basic liquid assets requirement - at least one third of the amount of a firm's fixed overheads requirement and 1.6% of the total amount of any guarantees provided to clients

Capital

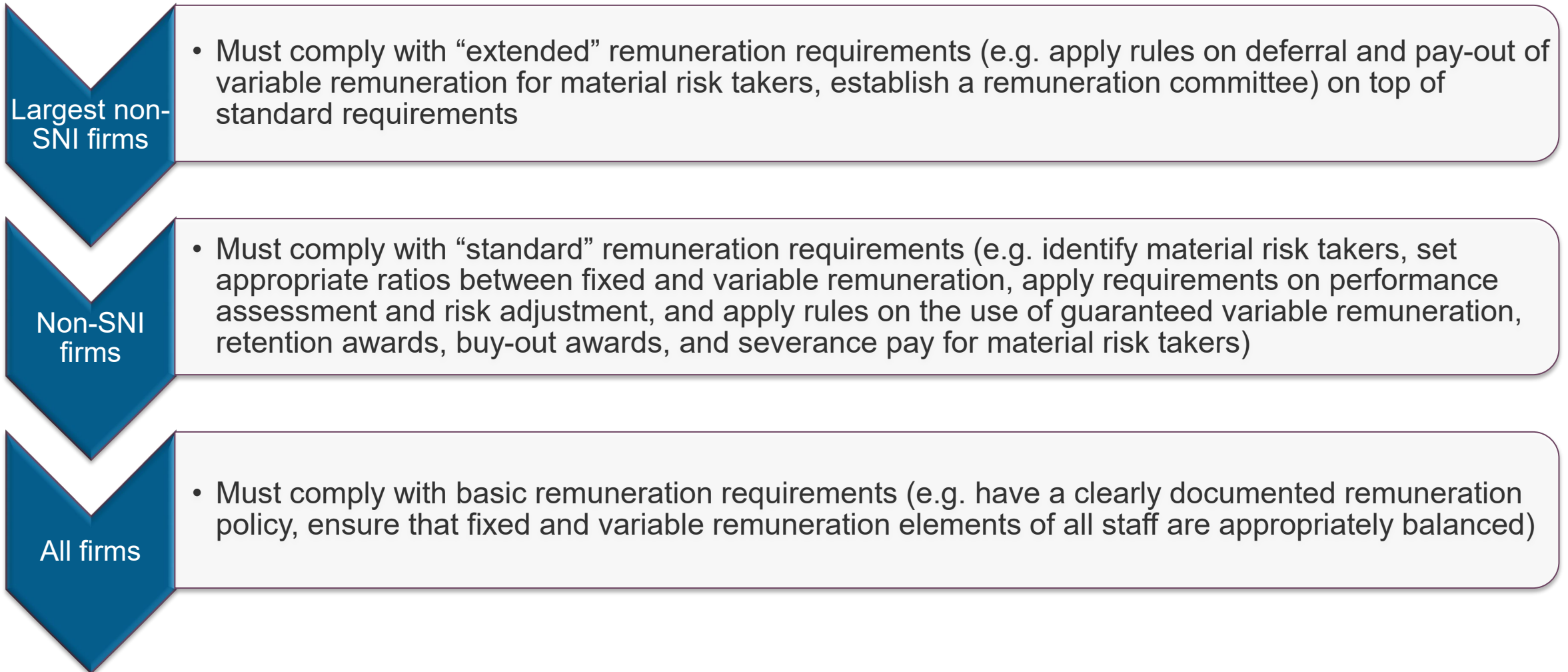
Own funds can consist of:

- Common equity tier 1 capital;
 - Additional tier 1 capital; and
 - Tier 2 capital
-
- At least 56% of a firm's own funds requirement must be met with common equity tier 1 capital
 - At least 75% of a firm's own funds requirement must be met with common equity tier 1 capital and additional tier 1 capital

Remuneration

- New framework applies from first performance year starting after 1 January 2022
- No bonus cap for IFPR firms, but requirements will be more formal/stringent for many firms
- Requirements depend on whether a firm is classed as an SNI, non-SNI, or larger non-SNI
- A firm will be classed as a larger non-SNI if:
 - (i) the value of its on-and off-balance sheet assets over the preceding four-year period is a rolling average of more than £300 million; or
 - (ii) the value of its on-and off-balance sheet assets over the preceding four-year period is a rolling average of more than £100 million (but less than £300 million), and it has trading book business of over £150 million, and/or derivatives business of over £100 million

Remuneration



Governance and risk management

- Largest non-SNI firms required to have risk, remuneration, and nomination committees (although may be able to use group committees)
- ICARA replaces ICAAP
- ICARA process will consolidate FCA requirements in relation to business model analysis, stress-testing, recovery planning and actions, and wind-down planning
- Senior Managers will be responsible for signing off on ICARA documentation
- FCA plans to use a “harm-led” approach rather than having a minimum Supervisory Review and Evaluation Process cycle for most firms



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FCA Market Watch 68 on web-based trading
platforms
David Berman

Market Watch 68

- Special edition on web-based trading platforms
- Seen as a growing area of risk by the FCA – concerned that market abuse surveillance arrangements by users of such platforms do not meet regulatory requirements, particularly in relation to orders which are deleted or otherwise do not result in a trade
- FCA expects firms and venues to take on board its observations and ensure they are monitoring all orders and transactions to detect and report potential market abuse
- FCA plans to continue visits to assess STOR arrangements, systems and procedures, and work to ensure that firms and venues consistently meet their regulatory obligations

FCA's concerns

- Growing use of electronic trading platforms for rates and fixed income products, but many of these platforms do not connect directly to users' trading systems and so order messages and orders that do not result in a trade are not systematically recorded
- This means users of web-based platforms may not be able to monitor all of their orders to detect potential market abuse
- Users are struggling to obtain useable data in a format suitable for surveillance

FCA's concerns

- Compliance teams may be unaware of the platforms used by their front office staff, or lack knowledge of the quantity of business undertaken on them
- Market abuse risk assessments often do not include business entered on web-based platforms, particularly orders which are deleted or otherwise do not result in a trade
- Some firms have been using web-based trading platforms before completing formal new business procedures, or lack governance processes for onboarding these platforms
- Where users are not capturing all trade and order data, it is likely these firms will not be meeting Article 25(1) of UK MiFIR order handling and record keeping requirements

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The EU's proposals for revisions to the MiFID II
framework
Rob Moulton

EU – MiFID review (markets issues)

- Proposed amendments to MiFIR
 - Which also transfers some provisions from MiFID to MiFIR
- Mix of ongoing updates, Capital Markets Union measures, and post-Covid points
- Issues to be addressed:
 - Absence of consolidated market data
 - Too much trading on unlit venues
 - Unnecessary complexity (post-Brexit)
- No equivalent measures being perused in the UK

MTFs

- Fear that too many multilateral systems are somehow avoiding MTF status
- Transfer definitions from MiFID to MiFIR (to attempt to increase harmonisation)
- Ongoing regulatory initiatives at national level
 - Post-Brexit challenges for UK firms redomiciling

Transparency waivers

- Minimum size threshold will prevent MTFs executing small trades under the reference price waiver
- Double volume cap to be replaced with a single 7% volume cap for trades executed under reference price waiver and negotiated trade waiver

Systematic internalisers

- Increase SI pre-trade quotation obligation
 - Must quote for trade sizes up to twice standard market size
 - Replicate the reference price waiver floor for trades undertaken by an SI without pre-trade transparency
 - SIs will not be allowed to match small trades at the mid-price

Consolidated tape provider

- Trading venues and SIs must contribute harmonised market data
 - New technical standards on data to be provided
 - New obligations to provide “minimum revenue targets” for market data consolidators
 - Intention to create a single, independent consolidator for each asset class

Trading obligation

- No leniency on the application of the obligation
- EU “official list” to be created, with perimeter being “shares that are admitted to trading on an EEA regulated market”
- Align the derivatives trading obligation under MiFIR with the clearing obligation for derivatives under EMIR Refit

Prohibition on firms from offering payment for order flow

- Firms acting on behalf of clients cannot receive PFOF
- Now similar to UK proposals (best execution, rather than best execution and conflicts, seen as key reason)
- Change from previously announced EU position (which had been focused on disclosure)

The background of the slide is a blue-tinted financial line chart. It features a grid of dashed lines and several jagged lines representing data trends. The lines are primarily blue and white, set against a dark blue background. The chart appears to be a candlestick or line chart, with the lines showing significant volatility. The overall aesthetic is professional and data-oriented.

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The confirmed changes to the UK MiFID rules on
research and best execution
Rob Moulton

SME research

- FCA confirms £200m threshold for SME exemption
 - No intention to align with EU's threshold as this would “reintroduce material bundling of fees and unacceptably high inducement risk”
 - FCA retains the view that “overall, the equity research reforms are positive...”
- Threshold will be calculated by average closing price at each month end over 24 months to 31 October
 - Once a year
 - Intended to reduce churn
- Corporate access for SMEs added to the exemption
 - Presumably, FCA has similar views to those on research

FICC research

FCA retains FICC research exemption...

- ...but on a different basis
 - Exemption applies to research on FICC instruments, rather than research received in connection with FICC investment strategies
 - Some complexity, and winners and losers, from this change
- Exemption is optional – firms may choose not to use it
- FCA declines to include macro-economic research in this exemption
- FCA refuses to be drawn on application of SEC no-action letters

Independent research providers and openly available research

- Independent research providers are exempt
- Openly available research is exempt
 - FCA reiterates its support for the ESMA Q&A
 - FCA grudgingly concedes that restrictions may be necessary to comply with regulation
 - Firms expected to be able to demonstrate how such measures are proportionate given the aim of insuring frictionless access
- All of the changes to the rules on research will apply from 1 March 2022

Best execution

- RTS 27 and 28 reports are not delivering their intended policy objective
- Remove the reporting obligation for both (from 1 December 2021)
- Note entirely different EU approach

FCA confirms new listing rules

- Largely confirms July 2021 Consultation Paper positions
- Key points
 - Limited form of dual class shares now permitted
 - Minimum market cap £30m
 - Free float reduced to 10% (generally no flexibility below this level)
 - FCA hints at willingness to allow waivers for three year financial track record requirement

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