

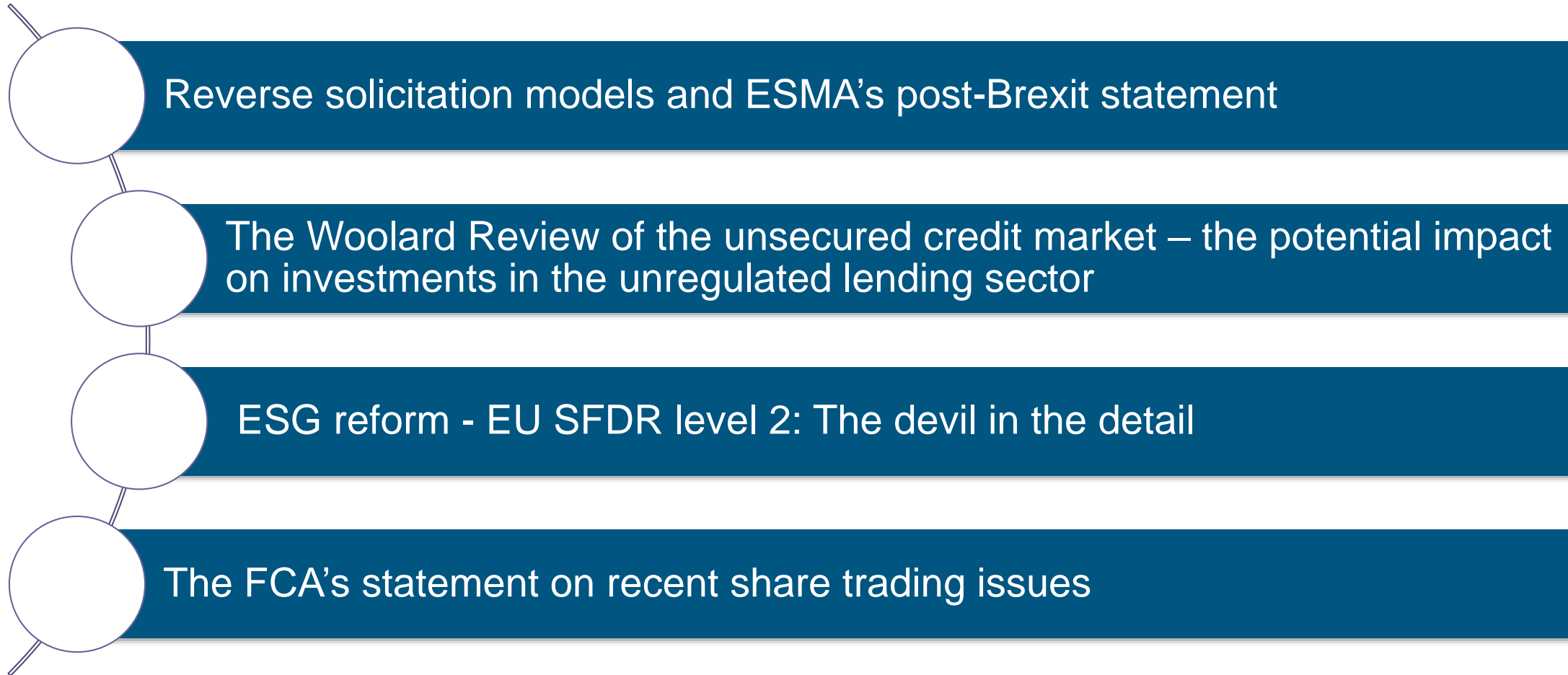


LATHAM & WATKINS

10 February 2021

Financial Regulation Monthly Breakfast Webcast

Overview





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Reverse solicitation models and ESMA's post-Brexit statement

Rob Moulton, Thomas Vogel and Axel Schiemann

Reverse solicitation

- Reverse solicitation in context
 - Characteristic performance, and solicitation, tests generally used as equal licensing triggers by EU Member States (but not universally so)
 - Something of an instinctive test
 - Pre-dates current global marketing potential through internet, social media etc.
 - Often seen as a means of explaining unlikely situations, rather than being a business model in its own right

Reverse solicitation

- *“Questionable practices by firms around reverse solicitation have emerged...including general clauses in their Terms of Business or through the use of online pop-up “I agree” boxes whereby clients state that any transaction is executed on the exclusive initiative of the client”*
- *“Every communication means used, such as press releases, advertising on internet, brochures, phone calls or face-to-face meetings should be considered to determine if the client or potential client has been subject to any solicitation, promotion or advertising...regardless of the persons through whom it is issued”*

Investment bank – sales and trading

- London based securities sales and trading function
- Has established an EU affiliate, but some clients have refused to move
- London sales people's role is to engage in dialogue with an investor client base
- Phone calls, morning summary emails, sales notes, Indications of Interest
 - Has decided not to open any new accounts for EU clients
 - Has decided not to make calls, send morning updates, send sales notes or send lols into the EU
 - Has decided to trade with EU clients who call in with orders

Investment banking

- Scenario 1 - all clients are in the UK, but capital markets activities are carried out including with investors in the EU
- Scenario 2 - the London bank is famous in a particular sector, and is approached by an EU-based client to advise (e.g. on a London listing)
- Scenario 3 - London team asked to provide M&A advisory services to an EU client looking to acquire an UK target

Private banking and wealth management

- Scenario 1 - only EU-based clients are expats who are currently tax resident in the EU but may return to the UK
- Scenario 2 - client is jointly served by EU-based private banker and UK-based specialist (with contractual documentation in place exclusively with the EU firm)

Funds

- Pre-Brexit, EU investor had informed UK bank of their interest in future investment opportunities (having turned down, after considering, a first potential investment)
- (Note – consider also AIFMD reverse solicitation test for marketing permissions)




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The Woolard Review of the unsecured credit market
– the potential impact on investments in the
unregulated lending sector

Becky Critchley

The Woolard Review of the unsecured credit market - background

- 26 recommendations to the FCA, sometimes working with government and other bodies, to make the unsecured credit market fit for the future
- FCA Board: “*strong and pressing case to bring buy-now pay-later business into regulation*”
- The use of BNPL products nearly quadrupled in 2020 and is now at £2.7 billion, with 5 million people using these products since the beginning of the COVID-19 pandemic
- Potential for consumer harm:
 - Not viewed by consumers as a form of credit
 - Some customers still think it is some form of financial service
 - Designed to increase consumer spending  increase in debt levels
 - No affordability checks or checks on vulnerable customers

The Woolard Review of the unsecured credit market – BNPL proposals

- Currently an exemption for credit agreements which are interest and fee-free and are repayable in 12 or less instalments within a year (under Article 60F(2) of the RAO).
- Lenders will need to be authorised and regulated by the FCA and subject to the full range of rules, *e.g.*:
 - Affordability checks, TCF, forbearance, treatment of vulnerable customers
 - Financial promotions regime
 - FOS
- Retailers referring customers to BNPL lenders would be credit brokers
- Impact?
 - Fewer firms offering BNPL
 - Small number of big providers becoming regulated
 - BNPL investors

The Woolard Review of the unsecured credit market – BNPL proposals

- Scope:
 - Not intended to catch all services using the exemption, e.g. dentists, sports club membership fees, gym membership, sport season ticket providers, short term invoice deferral
 - Insurance premiums?
 - Just “shopping” (“90% of transactions involve fashion and footwear”)?
- Timing:
 - Amendment to the Financial Services Bill 2019-2021?
 - Separate legislative change?
 - Prior consultation?
 - Transitional period?



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ESG reform - EU SFDR level 2: The devil in the detail
Nicola Higgs

EU SFDR: Entity level disclosures

Corporate Level Disclosures

	FMP	FA	Level I 10 Mar 2021	Level II RTS 1 Jan 2022	Level I 30 Dec 2022
Corporate Level <i>Publish on website</i>	•	•	(Art 3) Sustainability Risk Management Policy		
	•	•	(Art 4) Principal Adverse Impact Statement (a) information about their policies on the identification and prioritisation of principal adverse sustainability impacts and indicators (b) a description of the principal adverse sustainability impacts and of any actions in relation thereto taken or, where relevant, planned (c) brief summaries of Stewardship / CSR Policy	<p>A mandatory reporting template:</p> <ul style="list-style-type: none"> • sustainability indicators in relation to adverse impacts on the climate and other environment-related adverse impacts • sustainability indicators in relation to adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters <p>To note:</p> <ul style="list-style-type: none"> ▪ 15 mandatory indicators (15) and more opt-in indicators ▪ Separate indicators for investments in sovereigns (and supranationals) and real estate assets ▪ Consider PAI through “<i>all reasonable means available</i>”- “<i>a best effort to obtain the information either directly from investee companies, or by carrying out additional research, cooperating with third party data providers or external experts or making reasonable assumptions</i>” ▪ PAI metrics calculations to be undertaken on at least 4 specific dates during the year and accompanied by a historical year-by-year comparison ▪ Obligation to disclose how the engagement policies adapt where “there is no reduction of the principal adverse impacts over more than one reference period ▪ The first reference period should run from 1st January to 31 December 2022, with the first report to be <u>published in 2023</u> ▪ Prescribed statement when not considering principal adverse impacts 	
	•	•	(Art 5) Remuneration Policy		

EU SFDR: Entity level disclosures

Product / Service Level Disclosures

	FMP	FA	Level I 10 Mar 2021	Level II RTS 1 Jan 2022	Level I 30 Dec 2022
Product / Service Level <i>Publish on website</i>	•		(Art 10) Promotion of environmental or social characteristics (Art 8) and of sustainable investments (Art 9) For each ESG product: (a) a description of the investment objective (b) methodologies used (c) the information included in the pre-contractual disclosures (d) the information referred to in the periodic reports	For each product, information in relation to 12 different data points describe the environmental or social characteristics of financial products or the sustainable investment and the methodologies used. This includes the need to publish a two-page summary. To note: the disclosure of direct versus indirect investments has been moved from pre-contractual and periodic disclosures to the website disclosures.	Information on performance of products against sustainability objectives

EU SFDR: Product level disclosures

Product / Service Level Disclosures

	FMP	FA	Level I 10 Mar 2021	Level II RTS 1 Jan 2022	Level I 30 Dec 2022
Pre-contractual disclosures	•	•	(Art 6) Pre-contractual disclosures covering: (1) How are sustainability risks embedded; (2) The result of sustainability risk assessment process; (3) Specific disclosures for products with the following objectives	<p>The policy approach chosen for the pre-contractual granularity of information is of minimum standardisation of requirements, which includes mandatory templates while allowing for some tailoring of the approach to specificities of financial products:</p> <ul style="list-style-type: none"> ▪ <i>Mandatory template</i> ▪ <i>List of items to be included in the reporting indicating clearly the type of product and how the environmental or social characteristic (or combination thereof) or the sustainable investment objective of the product are achieved</i> ▪ <i>Additional items of disclosure where the product designates an index as a reference benchmark</i> ▪ <i>Requirements for products making sustainable investments regarding how the product complies with the “do not significantly harm” principle</i> 	FMPs: Whether and how a product considers principal adverse impacts on sustainability factors
	•	➤	(Art 8) environmental / social characteristics	A mandatory reporting template How a product with environmental or social characteristics meet those characteristics and if an index has been designated as a reference benchmark, whether and how that index is consistent with those characteristics	
	•	➤	(Art 9) sustainable investment	A mandatory reporting template Where a product has sustainable investment objectives and a) has a designated index as a reference benchmark, how that index is aligned with the sustainable investment objective and an explanation as to why and how that designated index aligned with the objective differs from a broad market index; or b) if no index has been designated as a reference benchmark, an explanation on how those objectives are to be attained	
	•	➤	(Art 9) reduction of carbon emissions	A mandatory reporting template	

EU SFDR: Product level disclosures

Product / Service Level Disclosures

	FMP	FA	Level I 10 Mar 2021	Level I & Level II RTS 1 Jan 2022	Level I 30 Dec 2022
Product / Service Level <i>Periodic reports</i>	•			Level 1: (Art 11) Periodic reports <ul style="list-style-type: none"> ➤ (Art 8) products - the extent to which environmental or social characteristics are met ➤ (Art 9) products – <ul style="list-style-type: none"> ○ the overall sustainability-related impact of the financial product by means of relevant sustainability indicators; or ○ where an index has been designated as a reference benchmark, a comparison between the overall sustainability-related impact of the financial product with the impacts of the designated index and of a broad market index through sustainability indicators <p>Level II RTS: Mandatory reporting template(s) for Art 8 and Art 9 products</p> <p>Requirements for products making sustainable investments regarding how the product complied with the “do not significantly harm” principle in relation to the principal adverse impact indicators</p>	
<i>Marketing literature</i>	•	•	(Art 13) Ensure that marketing communications do not contradict the information disclosed pursuant to SFDR		

EU SFDR: Article 8 products

Product name/legal identifier: [complete]

Environmental and/or social characteristics

This product: Promotes environmental or social characteristics, but does not have as its objective a sustainable investment

It does not invest in sustainable investments [tick when relevant]

It invests partially in sustainable investments [tick when relevant]

Has sustainable investment as its objective. Sustainable investment means an investment in an economic activity that contributes to an environmental or social objective, provided that the investment does not significantly harm any environmental or social objective and that the investee companies follow good governance practices.

Has a reference benchmark been designated for the purpose of attaining the environmental or social characteristics promoted by the financial product? [tick relevant box]

Yes

No



1 What environmental and/or social characteristics are promoted by this financial product?

- What sustainability indicators are used to measure the attainment of the environmental or social characteristics promoted by this financial product?

Sustainability indicators measure how the environmental or social characteristics promoted by the financial product are attained.

- Recital 22: Links the meaning of “promotion” to marketing activities rather than to the activity of supporting activities with E or S characteristics
- Recital 25 (Greenwashing): “It is necessary to address concerns about ‘greenwashing’, that is, in particular, the practice of gaining an unfair competitive advantage by recommending a financial product as environmentally friendly or sustainable, when in fact that financial product does not meet basic environmental or other sustainability-related standards. In order to prevent mis-selling and greenwashing, disclosure of any commitment **with regard to a minimum reduction of the set of potential investments** as a result of the application of the exclusion strategy is necessary to give end investors better visibility over the materiality of the offered strategy.”
- Article 8 disclosure should now be referred to “in a prominent statement” in the main body of the pre-contractual document specifying that “information related to environmental or social characteristics is available in a specific annex”
- Article 16 (draft RTS) requires to disclose “the **minimum proportion of the investments of the financial product used to attain the E or S characteristics promoted by the financial product in accordance with the binding elements of the investment strategy (...)**”
- The disclosure relating to derivatives has been narrowed to derivatives used to attain the E or S characteristics promoted by the financial product

EU Taxonomy – Article 8 products

- Information on which of the six prescribed environmental objectives under the Taxonomy Regulation that the relevant product contributes to
- A description of how and to what extent the investments underlying the product are economic activities that qualify as “environmentally sustainable” in line with the technical screening criteria (including disclosure of the proportion of investments in environmentally sustainable economic activities selected for the financial product, including details on the proportions of enabling and transitional activities as a percentage of all investments selected for the financial product)

EU SFDR: DNSH disclosures

- DNSH disclosures:
 - EU SFDR brought into line with EU Taxonomy – FMPs to disclose (1) how the product takes into account the indicators for adverse impact; and (2) whether the investments are aligned with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights
- Article 8 products:
 - Although there is no DNSH requirement for Article 8 products in the EU SFDR (a separate statement confirming the product does not pursue sustainable investments applies), the EU Taxonomy Regulation in essence requires the DNSH assessment to be performed from an environmental perspective



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The FCA's statement on recent share trading issues
Gabriel Lakeman

The FCA's statement

- The FCA's Statement (29 January 2021):
 - *“Buying shares in volatile markets is risky and you may quickly lose money. These losses are unlikely to be covered by the Financial Services Compensation Scheme.*
 - Broking firms are not obliged to offer trading facilities to clients. They may withdraw their services, in line with customer terms and conditions if, for instance, they consider it necessary or prudent to do so. Firms are exposed to greater risk and therefore more likely to need to take such action during periods of abnormally high transaction volumes and price volatility.*
 - We will of course take appropriate action wherever we see evidence of firms or individuals causing harm to consumers or market.”*
- Prompted by recent retail driven trading activity in a number of US equities and commodities, coordinated or encouraged via social media sites

Example communications

“I’m still holding. This is just ladder attacks from hedgies. My children will inherit this stock”

OverpricedAvocado

“To the moon!!!  ”

AlanGreenspan1192

“[Fund] has a short interest of 200% of float. Short squeeze now inevitable Friday”

MrDipple

“I can calculate the movement of the stars, but not the madness of men.”

Sir Isaac Newton (on the South Sea bubble)

Would this have been market abuse?

- Had something similar occurred in the UK:
 - UK MAR has an offence of “market manipulation” (UK MAR Article 12)
 - UK MAR is clearly intended to capture activity on social media:
 - *“Given the rise in the use of websites, blogs and social media, it is important to clarify that disseminating false or misleading information via the internet, including through social media sites or unattributable blogs, should be considered, for the purposes of this Regulation, to be equivalent to doing so via more traditional communication channels”* (UK MAR Recital (48))

Would this have been market manipulation?

Potential market manipulation offences	Issues
Trading/placing orders to give false or misleading signals? UK MAR Article 12(1)(a)	<ul style="list-style-type: none">• Lots of rumours – particularly on the way down• However, is there reason to think this was actually occurring, as opposed to genuine trading activity driving price?
Disseminating false or misleading information? UK MAR Article 12(1)(c)	<ul style="list-style-type: none">• Again, lots of questionable rumours, e.g. about the amount of short positions taken by funds• However, is it clear that individuals should have known the rumours were false or misleading?
Pump and dump? UK MAR Article 12(2)(d)	<ul style="list-style-type: none">• Many messages encouraging speculative purchasing• However, were authors concealing their own long positions?

Potential future developments

- Where does this leave us?
 - Regulators currently have limited tools for directly prohibiting this activity
 - If there is intervention, it is therefore unclear what form it could take, and who it would focus on
 - Various factors (*e.g.* PFOF; CfD market) make UK market structurally different from the US

Upcoming Webcasts



A COMPLIMENTARY WEBCAST

The 'Hybrid' Working Environment – A Risk Management Framework for the Future

Thursday, 25 February 2021 | 8:00 - 9:30 a.m. PST | 11:00 a.m. - 12:30 p.m. EST | 4:00 - 5:30 p.m. GMT

Latham & Watkins and FICC Markets Standards Board (FMSB) are pleased to invite you to a webcast on the future 'hybrid' working environment.

With a post-pandemic 'hybrid' working environment looking increasingly likely to become the 'new normal', our panel will explore the associated risks, challenges, and opportunities faced by financial institutions in the UK, the US and globally.

This session is designed for lawyers, compliance officers, HR, conduct and risk professionals, as well as senior managers in financial services firms.

Keynote Speaker:

•**Jonathan Davidson**, FCA

Moderator:

•**David Berman**, *Partner*, Latham & Watkins (London)

Panel:

•**Ulla Suomio**, *Markets Policy Division*, FCA

•**Frederic Jeanperrin**, *Managing Director, Norms, Controls and Governance*, Société Générale

•**Nicola Jolley**, *Head of Solution Sales*, National Australia Bank

•**Tracey McDermott**, **CBE**, *Group Head, Corporate Affairs, Brand & Marketing, Conduct, Financial Crime and Compliance*, Standard Chartered

•**Rob Moulton**, *Partner*, Latham & Watkins (London)

•**Martin Pluves**, *CEO*, FMSB

•**Ed Wicks**, *Head of Trading and Liquidity Management*, Legal & General Investment Management

Chatham House Rule will apply and this session will not be recorded

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