

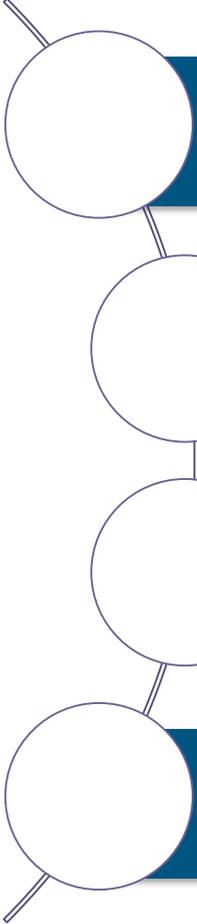


LATHAM & WATKINS

12 June 2019

Financial Regulation Monthly Breakfast Seminar

Overview



The FCA's recent competition case concerning information sharing in financial services

An update on the extraterritorial impact of US derivatives regulation, including the security-based swap regime

The latest on the MiFID Share Trading Obligation

FCA's latest feedback report on its 5 Conduct Questions

A blue-toned background featuring a financial line chart with multiple data series and a grid. The chart shows various peaks and troughs, with some lines appearing thicker than others. The overall aesthetic is professional and data-oriented.

LATHAM & WATKINS

The FCA's recent competition case concerning
information sharing in financial services
Rob Moulton

Background points

- Fine against Paul Stephany
 - What happened?
- Competition decision
 - Does it take into account MAR?
- Leniency for Newton
- Could still be appealed
- Definition of relevant market as small / mid-cap
 - Does this matter?

Our favourite FCA comments

- “If an asset manager obtains another asset manager’s views, it free-rides on that other’s expertise, experience or analysis” (5.36)
- “The FCA does not accept that asset managers need to share strategic information among themselves in order to address information asymmetries or to counter book-builders’ incentives to talk up the book” (5.103)
- If you say “yes”, “right” and “I will” the FCA may take these comments literally (i.e. American) not passively (i.e. English)

Question 1 – What can a book builder say?

- Theory

- “You would never talk about particular institutions. You may talk about types of institutions or a nationality of institutions...you might give colour on...order sizes that are starting to come through...helping the prospective investor to get a sense of where the price is forming and what the ultimate...shareholder list might look like”

- Practice

- “There are orders as low as 260 million and, you know, in fairness there are some big orders, a £20 million, a £25 million” and he had taken an order of £15 million at the same level of £270 million pre-new money
- “We have kind of got the majority of the orders at £270 million, market cap £270 million, with two...big orders at £260”
- “There are orders in the book higher and lots of orders at strike and...the bigger orders, yours and a few others have said £270”

Question 1 – What can a book builder say?

- *The FCA disagrees that this kind of information is very granular or more reliable in the context of a concerted practice. What matters is whether the information disclosed eliminated or substantially reduced uncertainty as to the discloser's expected conduct on the market. The FCA thinks that these examples do not do so*
- Remember MAR

Question 2 – what can a competitor say?

- Practice

- “I am strongly talking the range down to £700 - £800m”
- “I am trying to talk it down to £12 - £14 x”
- “I will really try to screw the price down towards £650 - £700m”
- “I won’t be participating in this range - £700m more realistic”

Question 2 – what can a competitor say?

- FCA's view – this information is *not sufficiently strategic* to be problematic – not statements of intention that eliminated or substantially reduced uncertainty
 - Disclosed a range rather than a specific price
 - Ranges disclosed varied significantly (£700 - £800, £650 - £700) giving a changing picture rather than a clear idea
 - Disclosures were made well before the books closed
- Remember MAR

Learning from FCA responses to FOIA requests

- 580 open enforcement investigations in February 2019, including:
 - 220 investigations into firms; and
 - 360 investigations into individuals, including:
 - 10 current enforcement investigations into Senior Managers; 7 into Certified Persons; and 10 into Conduct Rules Staff (some of which may have been announced since the response)
- 99 criminal investigations commenced in 2018 (125 in 2017), including:
 - 19 into companies; and
 - 80 into individuals
- 60 investigations into criminal insider dealing opened in the financial year (to 31 March) 2018 / 19, of which 55 were on-going in March 2019



LATHAM & WATKINS

An update on the extraterritorial impact of US
derivatives regulation, including the security-based
swap regime
Yvette Valdez

SEC Security-Based Swap Regime

Status of SBS Rulemaking

- While the SEC has finalized a number of SBS regulations under the Dodd-Frank Act, many key SBS rulemakings are still in proposed form, including, *inter alia*:
 - SBS data collection and reporting rules for SBSEFs
 - SBSEF business conduct standards
 - SBS antifraud rules
 - SBS recordkeeping requirements
 - Capital requirements and uncleared SBS margin requirements for non-prudentially regulated SBSDs/MSBSPs*
 - Cross-border application of SBS regulations
 - Risk Mitigation Techniques for uncleared SBS
- Media reports of CFTC Chairman Giancarlo having indicated that the SEC's SBS rulemakings are on deck for publication this summer

* While the PR Margin Rules apply to prudentially regulated SBSDs/MSBSPs (**PR Covered SBS Entities**) with respect to SBS transactions that are not cleared (**uncleared SBS**), the SEC has not yet finalized its own margin requirements for registered SBSDs/MSBSPs that are not subject to oversight by the Prudential Regulators

SEC Security-Based Swap Regime (cont.)

Compliance Date

- The compliance date for many of the SEC's finalized SBS regulations is contingent on the compliance date for the SBSD/MSBSP registration rules
- The SBSD/MSBSP registration rules compliance date will be the latest of the following:
 - **Six months following publication in the Federal Register of the SEC's final rules establishing capital, margin and segregation requirements for SBSDs/MSBSPs**
 - *The compliance date of the SEC's final SBSD/MSBSP recordkeeping and reporting rules*
 - *The compliance date of the SEC's final business conduct rules*
 - *The compliance date of final rules establishing a process for a registered SBSD/MSBSP to apply to the SEC to permit a statutorily disqualified AP to effect or be involved in effecting SBS on behalf of the SBSD/MSBSP*

* **Swap Counting Date.** Required to begin counting 2 months prior to the Compliance Date of the registration rules.

SEC Security-Based Swap Regime (cont.)

SBS Cross-Border Proposal *[proposed 10 May 2019]*

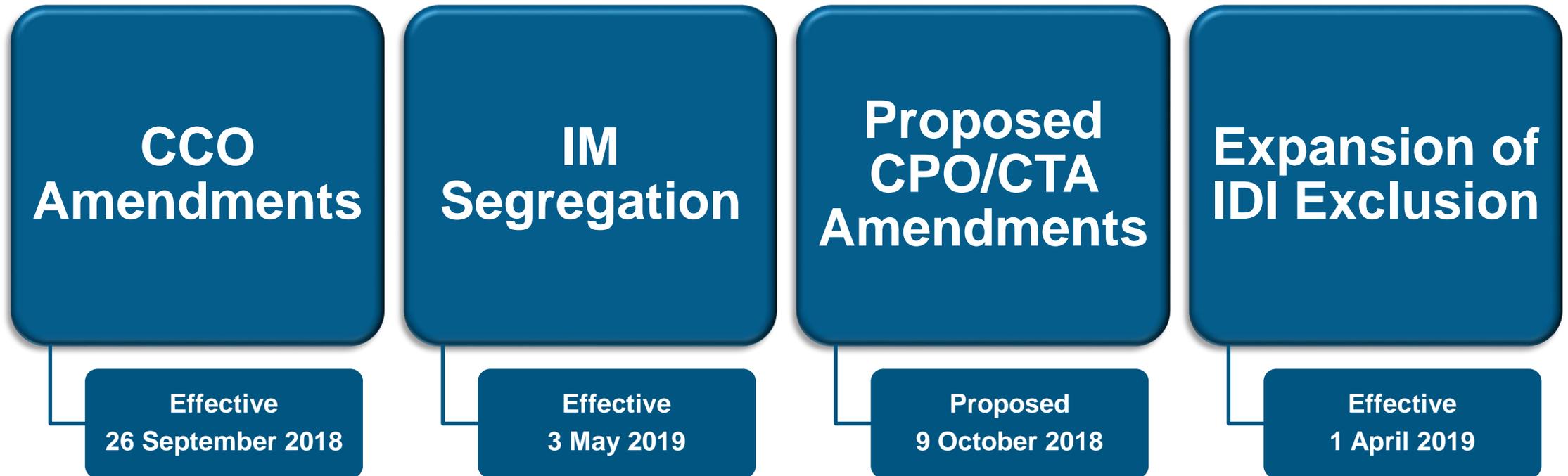
- The SEC has proposed a package of rule amendments and interpretive guidance to improve the framework for regulating cross-border SBS transactions and market participants
- If finalized, the proposal would:
 - Regulate SBS transactions that have been “arranged, negotiated or executed” by personnel located in the U.S.
 - Require that non-US resident SBSDs/MSBSPs certify and provide an opinion of counsel that the SEC can access their books and records and conduct onsite inspections/examinations
 - Address the cross-border application of statutory disqualification provisions
 - Prescribe questionnaires or employment applications that SBSDs/MSBSPs must maintain with regard to their foreign APs

Project KISS developments

Project Kiss = Keep It Simple, Stupid

- In May 2017, the CFTC voted to seek public input on simplifying and modernizing the CFTC's rules, regulations and practices to identify those areas that could be simplified to make them less burdensome and less costly
- Scope of input requested:
 - Registration
 - Reporting; Recordkeeping
 - Clearing
 - Executing
 - Miscellaneous

Project KISS developments (cont.)



Uncleared swap margin rules

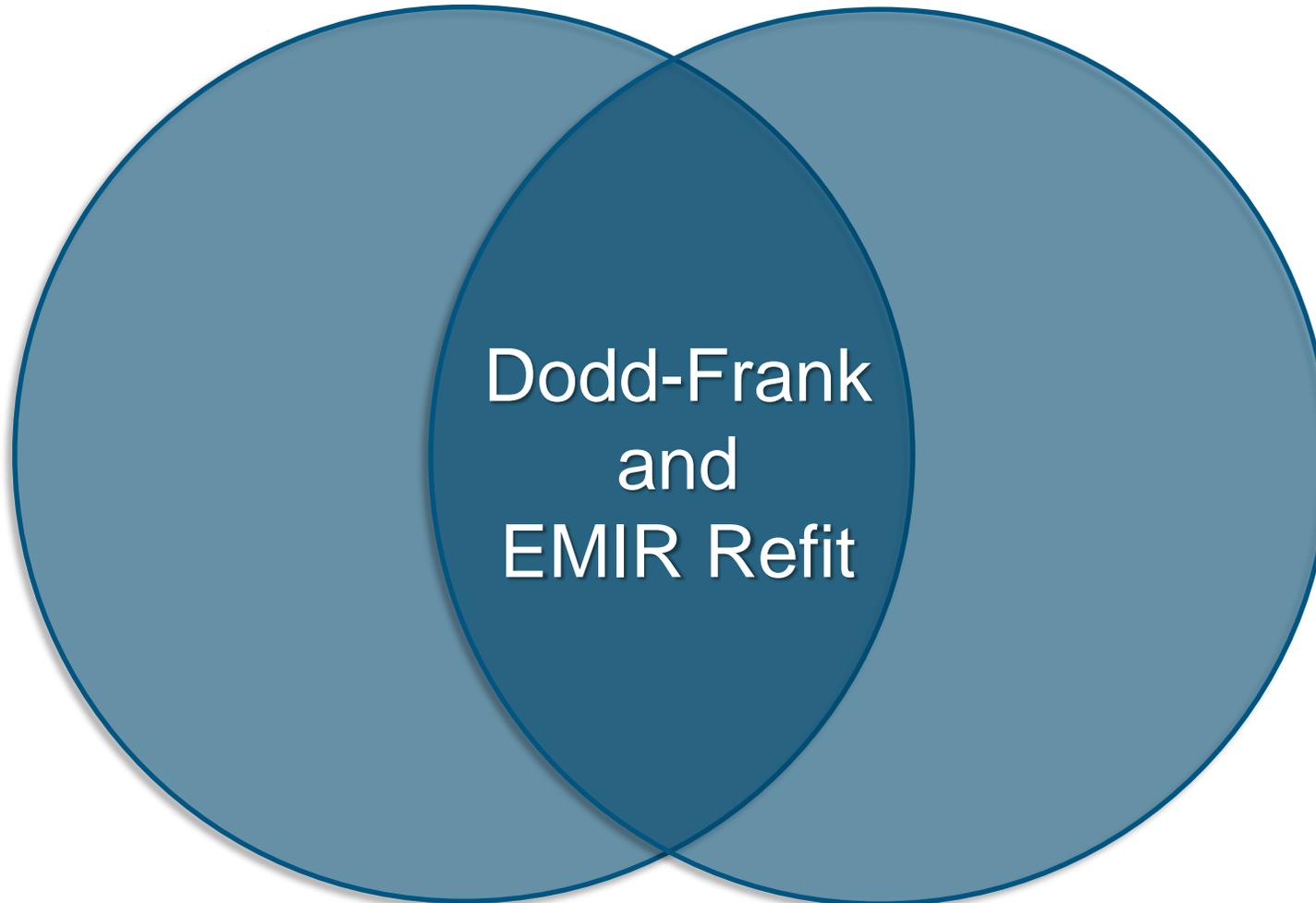
Phased-in Compliance Schedule

- IM/VM compliance dates are based on the average daily notional amount of uncleared swaps, uncleared SBS, FX forwards and FX swaps for each counterparty
 - Aggregated with each counterparty's respective affiliates
 - Computed for business days only

	VM Compliance Date	IM Compliance Date
AVERAGE DAILY AGGREGATE NOTIONAL AMOUNT		
> US\$3 trillion ^a	Sept. 1, 2016	Sept. 1, 2016 (Phase 1)
> US\$2.25 trillion ^b	March 1, 2017	Sept. 1, 2017 (Phase 2)
> US\$1.5 trillion ^c		Sept. 1, 2018 (Phase 3)
> US\$750 billion ^d		Sept. 1, 2019 (Phase 4)
> US\$8 billion		Sept. 1, 2020 (Phase 5)
≤ US\$8 billion		N/A
^a Calculated for March, April and May 2016 ^b Calculated for March, April and May 2017 ^c Calculated for March, April and May 2018 ^d Calculated for March, April and May 2019		

Cross-border developments

EMIR Refit – Alignment with Dodd-Frank





LATHAM & WATKINS

The latest on the MiFID Share Trading Obligation
Anne Mainwaring

Updated ESMA statement on the impact of a no-deal Brexit on the trading obligation for shares

- Updates ESMA's previous statement from March which specified certain GB ISINs as in scope of the EU MSTO
- ESMA has issued this new statement to mitigate the potential adverse effects that conflicting EU27 and UK share trading obligations may create, in particular for UK branches of EU27 firms and for EU27 branches of UK firms

Updated ESMA statement on the impact of a no-deal Brexit on the trading obligation for shares (cont.)

- ESMA has concluded that an approach to the share trading obligation based only on the ISIN of the share would be more likely to minimise any such risk of disruption and, consequently, the EU27 share trading obligation will not be applied to the GB ISINs included in its previous statement
- ESMA notes that this approach will avoid overlaps between the UK and EU27 share trading obligations if the UK adopts an approach that does not include EEA ISINs under the UK share trading obligation

FCA response

- The FCA does not believe that the risk of disruption from the potentially conflicting UK and EU27 share trading obligations is mitigated by ESMA's revised approach
- Applying the EU share trading obligation to all shares issued by firms incorporated in the EEA (EEA ISINs) would still cause disruption to investors, some issuers and other market participants, leading to fragmentation of markets and liquidity in both the EU and UK
- In the FCA's view the ISIN that a share carries does not and should not determine the scope of the share trading obligation

FCA response (cont.)

- “Some shares have their main or only centre of market liquidity outside the country in which the issuer is incorporated. This approach would place restrictions on a company’s access to investors and freedom to choose where they seek a listing on a public stock market”
- FCA specifies that reciprocal equivalence remains the best way of dealing with overlapping share trading obligations or, in the absence of this, applying both the UK and EU27 MSTOs in a way that maintains the status quo for a limited period of time after exit whilst longer term solutions are found

European Commission letter in relation to the treatment of bonds under the PRIIPs Regulation

- The reason or purpose for which retail investors acquire a bond, such as speculation, risk management or hedging is irrelevant for the purposes of determining whether it is a PRIIP
- “In consequence, even categories of bonds that could seem to fall outside the scope of the PRIIPs Regulation could still be based on contractual terms and conditions that would qualify these bonds as PRIIPs. Therefore, it is neither feasible nor prudent to agree ex-ante and in abstract terms whether some categories of bonds fall under the PRIIPs Regulation or not”
- Is this the end of the road?

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. The overall aesthetic is professional and data-oriented.

LATHAM & WATKINS

FCA's latest feedback report on its 5 Conduct
Questions
David Berman

Backdrop

- FCA recently published its latest (3rd) annual report on its 5 Conduct Question Programme
- The 5 Conduct Questions:
 1. What proactive steps do you take as a firm to identify the conduct risks inherent within your business?
 2. How do you encourage the individuals who work in front, middle, back office, control and support functions to feel and be responsible for managing the conduct of their business?
 3. What support (broadly defined) does the firm put in place to enable those who work for it to improve the conduct of their business or function?
 4. How does the Board and ExCo (or appropriate senior management) gain oversight of the conduct of business within their organisation and, equally importantly, how does the Board or ExCo consider the conduct implications of the strategic decisions they make?
 5. Has the firm assessed whether there are any other activities that it undertakes that could undermine strategies put in place to improve conduct?

Summary of latest findings

- “Culture and governance is one of our cross-sector priorities where we have a permanent and continuing focus. We introduced the 5 Conduct Question Programme...to help firms improve their conduct risk management and, ultimately, define cultural change”
- Many firms have made significant strides in improving their policies, processes, training and identification of conduct risk
- However, overall progress or embedding in some cases has been patchy or is in danger of stalling
- All firms are encouraged to note the FCA’s feedback
- Firms could pay more attention to developing and safeguarding positive behaviour in its own right

Summary of latest findings (cont.)

- Firms could take a more strategic approach to long-term staff development
- Focus on human skills
- Speak-up and whistleblowing: most firms have effective programmes in place to address continuing policy and process problems. The challenge remains to fully embed the desired changes of mind set across the whole organisation
- Non-financial misconduct (e.g. bullying, intimidation, sexual harassment) has emerged as a significant concern and is “widespread”
 - Many firms’ risk identification, response and mitigation is underdeveloped. “More managerial attention is needed here”

Summary of latest findings (cont.)

- If your firm has not prioritised conduct and culture, you are behind your peers and may be running significant, unrecognised and unmanaged levels of conduct risk
- If counterparties and other firms you deal with (e.g. via outsourcing arrangements) have not adequately prioritised their own approach to conduct, this can create a risk to your firm
- Questions for Boards and ExCos
- Next steps
 - “We will increasingly include some degree of testing and challenge to management and staff below Board and top management levels”

Some specific points of note

- Conduct and psychological safety
 - Middle layers would benefit from a greater focus on conduct initiatives
 - “Training on a wide range of human development skills is essential to support psychological safety. The learning point for firms is the benefit that can be delivered by human resource management through a strategic focus on well-developed staff”
- Leadership character and diversity and inclusion
 - Behavioural dimension – e.g. unconscious bias and inclusivity
 - Empathy and self-awareness – ability to relate to colleagues, peers etc.
 - Judgement and behaviour should improve to the firm’s ultimate benefit
- Most firms have now defined conduct risk as a separate category that sits sensibly alongside the other major risk types, such as Credit, Counterparty, Market and Operational risk

Some specific points of note (cont.)

- Tone from above (not just from 'the top')
- Some notable practices
 - Reverse mentoring programmes
 - Tailored internal surveys
 - Specific communication programmes around disciplinary actions – to provide transparency and perception of fairness
 - Training for senior staff on how to receive and deal with a challenge
 - Training: transition to broader use of face-to-face sessions continues
 - Conduct / ethics training incorporated into recruitment process
- Many firms have established new conduct committees, typically chaired by the CEO

Home | London Financial Regulatory Portal

London Financial Regulatory Home

The Practice

EU Benchmarks Regulation

Extraterritoriality

FinTech

Market Abuse Regulation

MiFID II Product Governance

MiFID II Research

PRIIPs

PSD2

SMCR

Guides

Thought Leadership

Monthly Breakfast Seminar



LONDON FINANCIAL REGULATORY PORTAL



 <p>EU Benchmarks Regulation more ></p>	 <p>Extraterritoriality more ></p>	 <p>FinTech more ></p>	 <p>Market Abuse Regulation more ></p>	 <p>MiFID II Product Governance more ></p>
 <p>MiFID II Research more ></p>	 <p>PRIIPs more ></p>	 <p>PSD2 more ></p>	 <p>SMCR more ></p>	



LATHAM & WATKINS

Questions?