

A blue-toned background image featuring a financial line chart with multiple data series plotted on a grid. The lines are thick and have a glowing effect, set against a dark blue background with a grid of small white dots.

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13 November 2019

Financial Regulation Monthly Breakfast Seminar

Overview



The ESAs' consultation on amendments to the PRIIPs KID and guidance on the application of PRIIPs to corporate bonds

FCA's Market Watch 62 on personal account dealing

The EC's review of the Benchmarks Regulation

An update on Brexit



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The ESAs' consultation on amendments to the
PRIIPs KID and guidance on the application of
PRIIPs to corporate bonds

Nicola Higgs

PRIIPs Regulation - Consultation

- Background
 - ESAs consulted on targeted “quick fix” amendments to the PRIIPs KID RTS in November 2018
 - However, respondents felt that this was not the right solution
 - The ESAs are now conducting a more thorough consultation on amendments to the PRIIPs KID RTS
 - The ESAs expect that any amendments to the RTS would take effect during 2021
 - The Commission is due to complete its review of the PRIIPs Regulation by 31 December 2019, but this is not expected to be completed on time

PRIIPs Regulation - Consultation

- What does the consultation cover?

Future performance scenarios

- The ESAs are looking at how the methodology and presentation could be improved, and whether illustrative scenarios should be used

Presentation of costs

- The ESAs are examining how to improve the methodology and presentation of costs, including improving compatibility with MiFID disclosures

Inclusion of past performance

- The ESAs are considering whether and how past performance information should be included in the KID

Multi-option products

- The ESAs are looking into ways to improve the clarity and usefulness of the information provided for these products

The UCITS exemption

- The ESAs are considering what amendments might need to be made to the PRIIPs KID in light of the potential end of the exemption for UCITS

PRIIPs Regulation - Consultation

- What does the consultation not cover?
 - The consultation only looks at potential amendments to the PRIIPs KID RTS – not the Level 1 text
 - However, the ESAs do want to hear if respondents think that the issues raised can only be resolved in the Level 1
 - The consultation does not deal with Level 1 issues, such as the scope of application
- Implications
 - Could see some improvements to the PRIIPs KID requirements, but not until 2021 at least
 - May help to make the KID more accurate and less misleading for consumers
 - Will not address issues with the Level 1 text; likely to have to wait even longer for any changes to the Level 1 to be agreed and enter into force

PRIIPs Regulation – ESAs' statement on corporate bonds

- Objectives
 - Address the negative consequences in functioning of retail bond markets
 - Mitigate risk of divergent application of NCAs of the PRIIPs Regulation
- Recommendation
 - Apply the guidance when supervising compliance with the requirements of the PRIIPs Regulation
 - Amend legislation to reflect more expressly the stated intention of the PRIIPs Regulation to address packaged or wrapped products, rather than assets held directly

PRIIPs Regulation – ESAs' statement on corporate bonds

- Treatment of the make whole
 - ESA position - *The inclusion of a clause that allows the issuer to pay off the remaining debt early using a reference rate to determine the net present value of future coupon payments that will not be paid (i.e. make whole) is expected to mean that the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values. However, where the mechanism to calculate the discount rate is known in advance to the retail investor, this could be considered as a separate case, which does not satisfy the criteria in Article 4(1)*

PRIPs Regulation – ESAs’ statement on corporate bonds

Further guidance on scope

Instrument	Authority
Corporate shares	Recital 7 PRIIPs Regulation
Sovereign bonds	Recital 7 PRIIPs Regulation
Government (/local authority) bonds	Article 1(2)(b) Prospectus Directive & Article 2(2)(d) of the PRIIPs Regulation
Government guaranteed bonds	Article 1(2)(d) Prospectus Directive
Central bank issued instruments	Article 1(2)(b) Prospectus Directive (as per above analysis)
Deposits	Article 2(2)(c) PRIIPs Regulation
Certain credit institution issued debt instruments (subject to various conditions)	Article 1(2)(f) Prospectus Directive
Fixed rate notes	<p>FCA Policy Statement, Annex 2, Point 6</p> <p>A fixed rate note would not, in principle, meet the definition of a PRIIP being “an investment where, regardless of its legal form, the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets that are not directly purchased by the retail investor.”</p>
Floating rate notes linked to interest rates	<p>European Commission and European Supervisory Authorities workshop in July 2016.</p> <p>(Further, the ESAs’ Discussion Paper 2014 states deposits “solely exposed to interest rates” (Recital 7) are out of scope.)</p>



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FCA's Market Watch 62 on personal account dealing
Stuart Davis

Context

- 5 Conduct Questions Approach – firms must identify market abuse conduct-related risks
- Market Watch 60 – risk of individuals using personal accounts to trade on inside information
- SMCR conduct rule 5 – ‘observing proper standards of market conduct’ applies to individuals dealing through personal accounts
- Review into wholesale broking firms:
 - Concerns raised around firms’ policies, controls and monitoring of PAD
 - Substantial variation in practice and standards around PAD
- FCA setting out poor practices and encouraging all firms to review their PAD policies and systems and controls against a broad set of rules and principles

Summary of rules and principles applicable to PAD

1. The Market Abuse Regulation
2. COBS 11.7 and COBS 11.7A
3. MiFID II
4. FCA Principles for Business
5. APER 4.1. Statement of Principle 1. An approved person must act with integrity in carrying out his accountable functions.
6. APER 4.2 Statement of Principle 2. An approved person must act with due skill, care and diligence in carrying out his accountable functions.
7. SM&CR

Core PAD rules

- COBS 11.7A applies in relation to MiFID, equivalent third country or optional exemption business
- COBS 11.7 applies in relation to all other business
- Requires firms to establish a control framework to reduce the risk that PAD:
 - Conflicts with the interests of firms' clients
 - Results in market abuse (including front-running)
 - Creates a conflict between the employee's personal interest and the obligation to report STORs
- Requires clear policies and processes, culture of adherence, effective monitoring and investigation of breaches with disciplinary action where appropriate

FCA concerns

- Employees in front-office roles not appearing to understand the PAD policy despite having signed attestations
- Perception that ignorance of PAD policies provides reasonable mitigation
- Non-declaration of external accounts to employers and/or circumventing requirements
- Employees trading in breach of the relevant policies including:
 - Trading in products (e.g. spread bets) on the firm's own shares
 - Dealing in conflict with professional decisions/ recommendations (e.g. research analyst trading against own recommendations)
 - Copying client orders (e.g. where the client's order subsequently appears suspicious)

FCA concerns (cont.)

- Front-running of client orders
- Where breaches become evident, firms not investigating, taking mitigation steps, or taking disciplinary action

Things to consider when reviewing a PAD policy

- What is the conflict or market abuse risk considering the firm's business model and how can those risks be mitigated?
- Are there staff for which these risks cannot be mitigated effectively?
- What effective monitoring should be in place given many markets are open round the clock (e.g. CFDs and spread betting markets)?
- How does the firm ensure employees are aware of their obligations?

Things to consider when reviewing a PAD policy

- Should firms rely on employees to act with integrity/to follow internal procedures? What level of post-trade monitoring is needed to ensure compliance/detection? How does the firm utilise post-trade monitoring to identify suspicious activity and report it to the FCA?
- Are processes for assessing PAD requests/notifications appropriate?
- Are senior managers leading by example? FCA expects senior managers to be strict advocates of compliance

Wholesale Broking Market Study: Concerns

- FCA reviewed PAD policies and processes across a sample group
- Analysed quantitative data on PAD activity by employees, including number of PAD applications, trade volumes, types of products, markets traded, number of refusals, number of policy breaches and number of STORs submitted relating to PAD

Wholesale Broking Market Study: Concerns

- FCA's concerns:
 - Substantial variation in practice and standards
 - Low PAD volumes / rates of pre-approval may indicate not all trades being reported by employees
 - Low identification of breaches of PAD policies is indicative of weaknesses in culture and controls
 - High trading frequencies by some individuals (e.g. several times per day)
 - No submission of STORs for PAD in the last year across the sample group (contrasts poorly with other sectors)
 - Indications of a lack of effective monitoring and management of risks

Wholesale Broking Market Study: Controls to consider

- Effective policies (see previous slide)
- Consider low volumes of PAD trades/STORs as a potential indicator that policies are not effective
- Regular attestations
- Requirement of pre-approval on all PAD trades vs pre-approval only on certain instruments?
- Limitations on number of PAD trades employees can make per day

Wholesale Broking Market Study: Controls to consider

- Pre and post-trade analysis of PAD trades:
 - Review indicators of insider dealing (e.g. price movements, news and corporate actions)
 - Cross-referencing PAD trades with those of clients in specified window around PAD trade date
 - PAD trades inputted into market abuse surveillance system for monitoring alongside client trades
- Training should be designed to ensure compliance
- Appropriate follow-up to breaches, including investigation and disciplinary action



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The EC's review of the Benchmarks Regulation
Becky Critchley

The 'BMR Review'

- Deadline for responses is 6 December 2019
- European Commission will use the responses to submit a report to the European Council and Parliament by 1 January 2020
- BMR mandates a review of a number of areas, however additional areas are included
- Critical benchmarks:
 - Updates required to address situations where a critical benchmark is no longer considered to be representative
 - Approval of cessation plans
 - Additional obligations on supervised users of critical benchmarks?
 - Appropriateness of supervision by colleges

The 'BMR Review'

- Third-country benchmarks:
 - Particular issue with the continued availability of certain FX spot rates for currencies that are not fully convertible
 - Lack of incentives for third-country administrators
 - Asks for suggestions and improvements
- Authorisation and registration
 - New powers to suspend authorisation for specific benchmarks?
- Scope
 - Impact on non-significant benchmarks and benchmarks that by their nature are less prone to manipulation
 - Thresholds for each category of benchmark

The 'BMR Review'

- ESMA register
 - Feedback on the general functionality
 - Should a list of benchmarks for EU administrators be included?
- Benchmark statements
- Climate-related and commodity benchmarks
 - Views on the correct way to supervise climate related benchmarks
 - Appropriateness of the commodity benchmark regime

Update on IBOR transition

- Recent observations on IBOR transition

A blue-toned background featuring a financial line chart with a grid. The chart shows a line that fluctuates, with a notable dip and recovery. The overall aesthetic is professional and data-oriented.

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An update on Brexit
Anne Mainwaring

Brexit delay

- Extension to 11.00 p.m. on 31 January 2020
- The FCA confirmed that as a result firms did not need to take action to implement their Brexit contingency plans for 31 October 2019
- The FCA also emphasised that this means firms must continue to comply with existing regulatory requirements, including those relating to MiFIR transaction reporting and EMIR trade reporting
 - Previous statements for firms in relation to the FCA's expectations in the run up to a no deal scenario are therefore suspended for the time being and firms are expected to report in full as normal
- The FCA has also extended the date by which firms and funds can notify for entry into the temporary permissions regime

Treasury committee

- Following the dissolution of parliament on 6 November 2019 all select committees have ceased to exist and accordingly all inquiries have been closed
- This includes
 - The Future of Financial Services in the UK after Brexit Inquiry
 - RBS's Global Restructuring Group and its Treatment of SMEs Inquiry
 - Service Disruption at TSB Inquiry
 - Independent Review of the Financial Ombudsman Service Inquiry
 - Decarbonisation of the UK Economy and Green Finance Inquiry
 - IT Failures in the Financial Services Sector Inquiry

EMIR validation rules

- The FCA has updated its statement on the reporting of derivatives under the UK EMIR regime in a no-deal scenario
- In the event the UK leaves the EU without a deal on 31 January 2020, UK reporting counterparties and UK Trade Repositories must use the UK EMIR validation rules when submitting derivative transactions entered into from 11.00 p.m. on 31 January 2020 onwards
- The FCA has published a table which highlights when the UK validation rules diverge from ESMA's EMIR validation rules

Withdrawal agreement

- Transition period in which UK continues to be subject to all EU rules
- UK retains rights as a member state apart from involvement in EU institutions
- Transition will end on 31 December 2020 but can be extended once for up to two years if both sides agree



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Other Issues

FCA – employee mental health

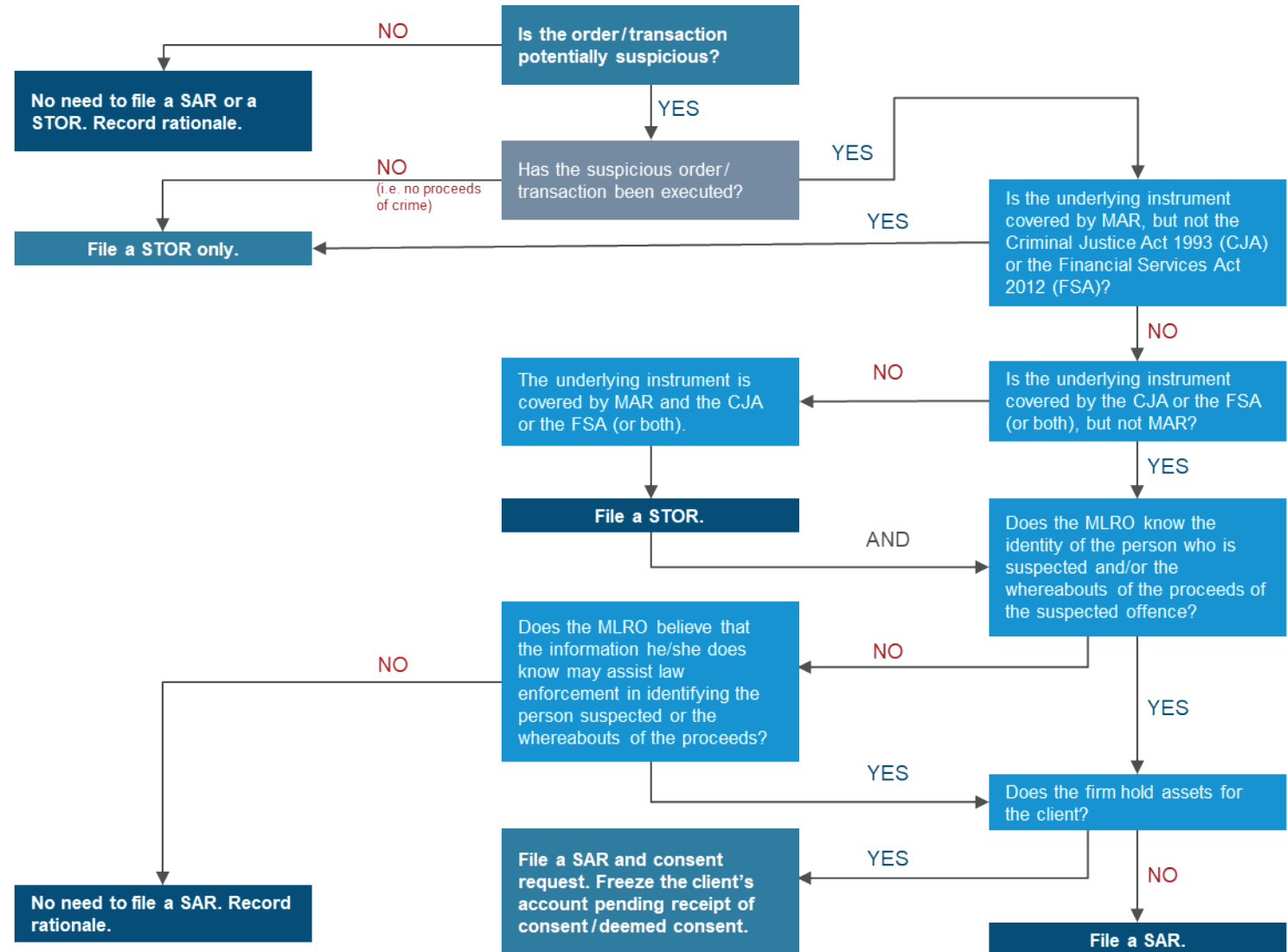
- David Blunt (Head of the Conduct Specialists Department, Supervision)
 - Senior Managers are responsible for the work environment and its impact on mental health
 - Staff who are unduly stressed, under pressure or overworked have a negative impact on themselves, the firm and its customers
 - Firms which appoint, promote or leave toxic team leaders in their roles will be hard pressed to demonstrate a good culture

Tullet Prebon fine

- Excess hospitality
- Cultural impact on work environment
- Judging yesterday by today's standards (?)
- Data requests
- Relevance in today's environment?

Filing STORs and SARs – Navigating The Overlapping Regimes

The question of whether a firm needs to file a suspicious transaction and order report (“STOR”) under the Market Abuse Regime (“MAR”), or a suspicious activity report (“SAR”) under the Proceeds of Crime Act 2002 (“POCA”), or both can be complex. STORs and SARs serve different purposes, and the authorities have been critical of firms thinking that filing a report under one regime discharges their obligations under the other. Recent advice from the FCA (in a letter to UK Finance dated 6 September 2019) confirms that “firms will have to consider, on a case by case basis, whether to submit a STOR, SAR, or both”. This chart is designed to assist those making that decision.



Private Bank Roundtable

Providing legal and compliance professionals working within private banks a quarterly update on areas directly impacting private banks and their clients. You will also have the opportunity to ask questions relating to market developments and to meet with peers.

Next Roundtable: Tuesday, 17 December



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