LATHAM & WATKINS

10 November 2021

Financial Regulation Monthly Breakfast Webcast

Overview

- Recent ESG developments
- ESMA’s statement on investment recommendations made via social media
- HM Treasury’s consultation on regulating buy-now pay-later products
- Horizon scanning for the year ahead, following publication of the FCA’s latest Regulatory Initiatives Grid

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Recent ESG developments

Nicola Higgs and Anne Mainwaring

UK Government Releases Roadmap to Sustainable Investing

- On 18 October 2021 the UK government released a report titled “Greening Finance: Roadmap to Sustainable Investing”
- The government states that it views the task of “greening the financial system” as composed of three fundamental phases:
    - Phase 1: Informing investors and consumers – addressing the information gap for market participants, ensuring a flow of decision-useful information on environmental sustainability from corporates to financial market participants
    - Phase 2: Acting on the information – creating expectations and requirements that this sustainability information is mainstreamed into business and financial decisions, for example in risk management and investor stewardship
    - Phase 3: Shifting financial flows – ensuring that financial flows across the economy shift to align with the UK’s net zero commitment and wider environmental goals

UK Government Releases Roadmap to Sustainable Investing

- The Roadmap addresses the first phase: informing investors and consumers and addressing the information gap in relation to environmental and sustainability issues between corporates and investors

Sustainability Disclosure Requirements

- The Roadmap expands on the Sustainability Disclosure Requirements (SDR) announced by the Chancellor at his Mansion House speech in July 2021, and states that SDR will create an integrated framework for decision-useful disclosures on sustainability across the economy by bringing together existing sustainability-related disclosure requirements under one integrated framework

Sustainability Disclosure Requirements

- SDR builds on the UK's TCFD implementation and will cover three types of disclosure:
  - **Corporate disclosure**: Subject to consultation, corporate disclosure will involve reporting under ISSB standards and reporting the Taxonomy alignment of companies, and will build on previously announced disclosure requirements for UK listed companies and large private companies
  - **Asset manager and asset owner disclosure**: Asset managers and asset owners will face new requirements to disclose how they take sustainability into account when making investment decisions
  - **Investment product disclosure**: Creators of investment products will face new requirements to report on sustainability impacts, risks, and opportunities, which will form the basis of a sustainability labelling regime

UK Taxonomy

- Reporting against the UK Taxonomy will form part of SDR
- The Green Technical Advisory Group (an independent body established in June 2021) will develop a set of technical screening criteria that will underline each of the six environmental objectives
- TSC for objectives 1 and 2 will be subject to consultation in Q1 2022, ahead of the government’s plan to table legislation later in 2022, whilst the remaining four TSC are scheduled for consultation in Q1 2023
- This follows the approach of the EU Taxonomy

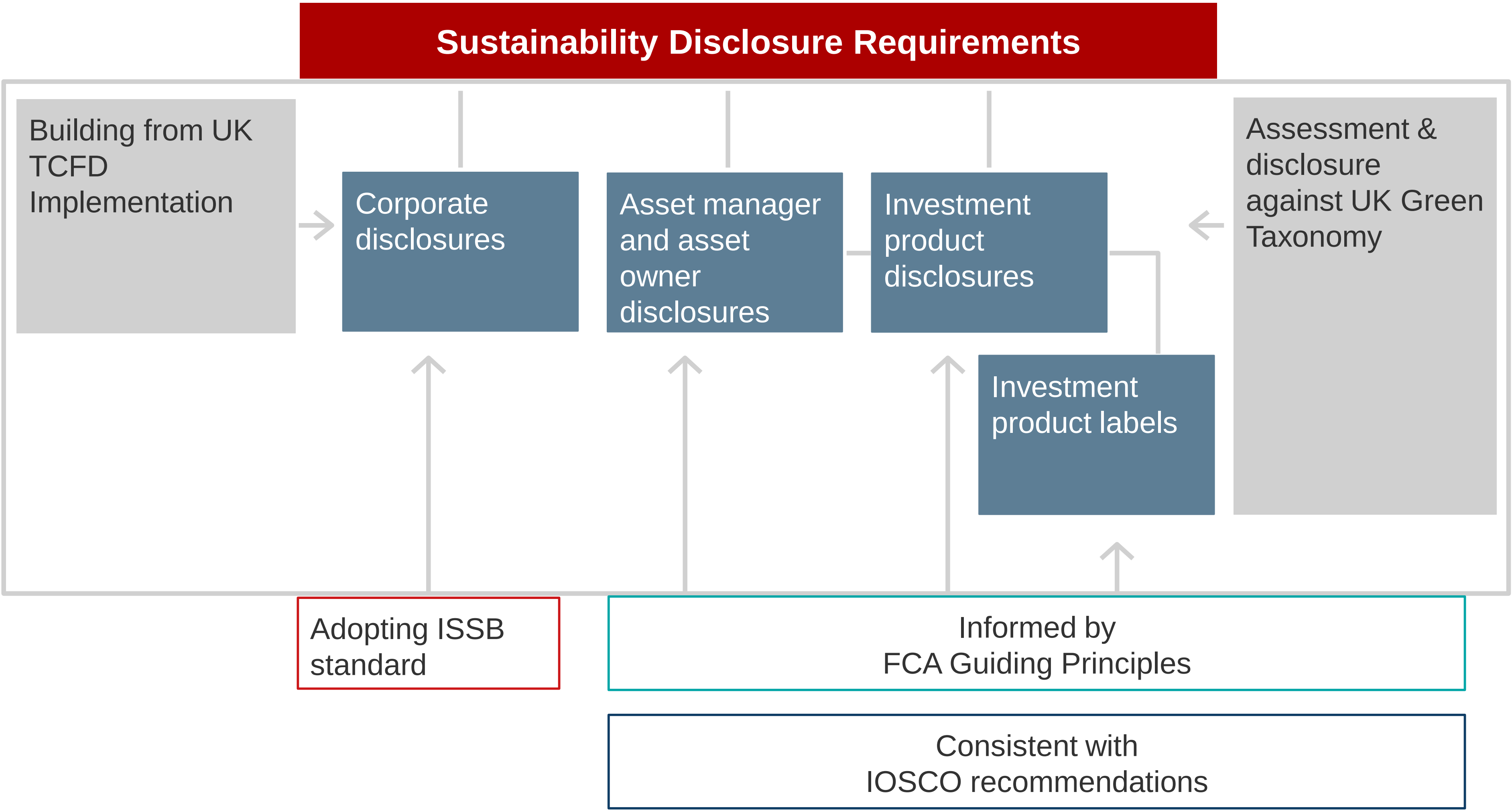
Government expectations

- The government sets out its expectations that asset managers, asset owners and the service providers that support them:
  - Apply to become a signatories of the UK Stewardship Code 2020
  - Take into account the information eventually generated by SDR when allocating capital
  - Actively monitor and challenge companies that they have invested in to promote sustainable value generation
  - Be transparent about their own and their service providers’ engagement and voting
  - Provide leadership, for example by joining a Race to Zero-accredited net zero initiative for the financial sector, and back up this commitment by publishing a transition plan by the end of 2022

Recent UK developments

- 3 November 2021: FCA launches Discussion Paper on:
  - Sustainability Disclosure Requirements (SDR)
    - SDR will set out disclosure requirements for corporates, asset managers, and asset owners, modelled on ISSB
    - SDR will also include disclosure requirements relating to the forthcoming UK Taxonomy
    - Extends UK mandatory TCFD (climate disclosures) → Broader sustainability disclosures + ‘double materiality’
    - Apply at entity & product level
    - Scope – geography?
  - ESG Product Labels
    - Scope – products?
    - Scope – geography?
- 7 December 2022: Deadline for feedback to FCA

Inputs to SDR



Product labelling (1) – potential approach

Product label

Disclosure layer 1:
aimed at consumers

Consumer-facing disclosures containing key product-level information

Disclosure layer 2:
aimed at institutional investors and other stakeholders

Detailed disclosures at product and entity level on sustainability risks, opportunities and impacts

Product labelling (2) – potential approach

		Sustainable		
Not promoted as sustainable	**Responsible** (may have some sustainable investments)	**Transitioning** (sustainable characteristics, themes or objectives; low allocation to Taxonomy-aligned sustainable activities)	**Aligned** (sustainable characteristics, themes or objectives; high allocation to Taxonomy-aligned sustainable activities)	**Impact** (objective of delivering positive environmental or social impact)
SFDR Article 6	SFDR Article 8	SFDR Article 8	SFDR Article 9	SFDR Article 9

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UK v EU ESG Reform Timeline

2021 | **2022** | **2023**

EU

10 Mar 21
SFDR
Level 1

22 Oct 21
SFDR
Revised RTS published

1 Jan 22
EU Taxonomy
(Climate Mitigation & Adaptation)

1 Jul 22
SFDR
Level 2
EU Taxonomy Sustainability disclosures come into effect (Climate Mitigation & Adaptation)
Updates to pre-contractual product disclosures

1 Aug 22
MIFID II / AIFMD / UCITS
ESG amendments to sectoral legislation come into effect
MiFID II organisational requirements

22 Nov 22
MiFID II
ESG amendments to sectoral legislation come into effect
MiFID II organisational requirements

30 Dec 22
SFDR
FMPs must update pre-contractual product disclosures to explain whether and, if so, how their products consider PAIs

1 Jan 2023
EU Taxonomy
(Environment)

UK

22 Jun 21
FCA CP TCFD
Climate-related disclosures

19 Jul 21
FCA Guiding Principles
For the design, delivery and disclosure of ESG fund products

3 Nov 21
FCA DP
SDR & Investment Labels

Q4 21
FCA PS TCFD
Climate-related disclosures

1 Jan 22
FCA TCFD
Enhanced climate-related disclosures for asset managers, life insurers and FCA-regulated pension providers take effect for in-scope firms with AUM of more than £50 billion

Q1 22
FCA CP
Diversity in financial services

Q2 22
FCA CP
SDR & Investment Labels

Q3 22
FCA PS
Diversity in financial services

Q3/4 22
FCA CP
Prudential ESG disclosures

End 22
UK Taxonomy
UK will develop Technical Screening Criteria to define what activities are environmentally sustainable

1 Jan 23
FCA TCFD
Enhanced climate-related disclosures for asset managers, life insurers and FCA-regulated pension providers take effect for in-scope firms with AUM of less than £50 billion

30 Jan 23
FCA TCFD
First enhanced climate-related disclosures to be made by in-scope firms with AUM of more than £50 billion

30 June 24
FCA TCFD
First enhanced climate-related disclosures to be made by in-scope firms with AUM of less than £50 billion

Other FCA focus areas

Business Plan 2021/22 Outcomes - ESG

High-quality climate- and sustainability-related disclosures

Trust and consumer protection from misleading marketing and disclosure

Governance arrangements for effective ESG

Active investor stewardship

Integrity in the market for ESG-labelled securities

Innovation in sustainable finance

Business Plan 2021/22 Outcomes – D&I

Diverse representation at all levels

Inclusive cultures

Products that reflect the diverse needs of consumers, offer fair value and are delivered in a fair and accessible way

Core principles

- Global solutions to global problems
- Walking the walk
- Building an ESG capability beyond climate
- Supporting positive market-led solutions
- Influence beyond rulemaking
- Maximising impact
- Readying for a digital and data-led world

FCA Refreshed ESG Strategy

- The FCA's refreshed ESG strategy sets out the FCA's target outcomes and the actions they expect to take to deliver these
- FCA has built on the core themes of the previous strategy: Transparency, Trust and Tools
- In addition two further themes have been added: Transition and Team
- These aim to: support a market-led transition to a net zero, sustainable future (Transition) and ensure that the FCA has the right organisational structures, resources and capabilities in place to appropriately integrate net zero and ESG considerations in its work across (Team)

SFDR – Final Report on draft Regulatory Technical Standards on Taxonomy Related Product Disclosures

- The ESAs published the draft RTS on taxonomy related product disclosures under SFDR on 22 October 2021
- This has been achieved by amending the existing finalised draft RTS and the accompanying templates in order to minimise duplication and complexity by creating a single ruleset
- The Commission has three months to adopt the RTS and the European Parliament and Council will then have three months to scrutinise the RTS (subject to the ability to extend this period by a further three months)
- The Level II requirements are due to apply from 1 July 2022

Key changes

- The ESAs changed their previous proposal to derogate from the general SFDR RTS relating to the principle of Do No Significant Harm (DNSH) for taxonomy-aligned sustainable investments
- Accordingly an investment that meets the Taxonomy "environmentally sustainable" test will no longer automatically qualify as an SFDR "sustainable investment" – instead both tests will need to be applied
    - *As a result of a legal analysis the ESAs concluded that it is not possible to derogate from the general SFDR DNSH RTS for sustainable investments that are taxonomy-aligned, that derogation has been removed. As a result, the DNSH related rules will be applied to all sustainable investments including the taxonomy-aligned investments*
- Changes to mandatory templates – including for non-taxonomy aligned products

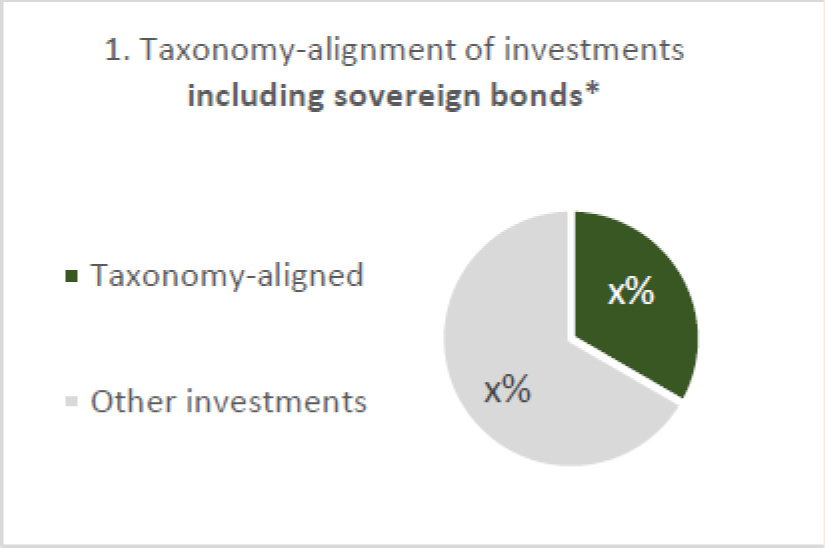
Mandatory template (continued)

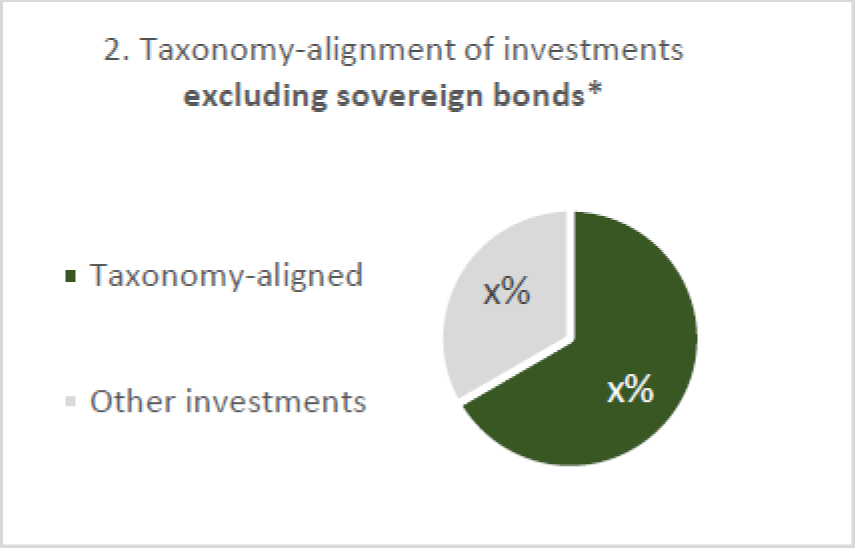
Does this financial product have a sustainable investment objective? *[tick and fill in as relevant, the percentage figure represents the minimum commitment to sustainable investments]*

☐ Yes	☒ No
☐ It will make a minimum of **sustainable investments with an environmental objective:** ___%	☐ It **promotes Environmental/Social (E/S) characteristics** and while it does not have as its objective a sustainable investment, it will have a minimum proportion of ___% of sustainable investments
☐ in economic activities that qualify as environmentally sustainable under the EU Taxonomy	☐ with an environmental objective in economic activities that qualify as environmentally sustainable under the EU Taxonomy
☐ in economic activities that do not qualify as environmentally sustainable under the EU Taxonomy	☐ with an environmental objective in economic activities that do not qualify as environmentally sustainable under the EU Taxonomy
	☐ with a social objective
☐ It will make a minimum of **sustainable investments with a social objective:** ___%	☐ It promotes E/S characteristics, but **will not make any sustainable investments**

Mandatory template example (continued)

The two graphs below show in green the minimum percentage of investments that are aligned with the EU Taxonomy. As there is no appropriate methodology to determine the Taxonomy-alignment of sovereign bonds*, the first graph shows the Taxonomy-alignment in relation to all the investments of the financial product including sovereign bonds, while the second graph shows the Taxonomy-alignment only in relation to the investments of the financial product other than sovereign bonds.





* *For the purpose of these graphs, 'sovereign bonds' consist of all sovereign exposures*

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ESMA’s statement on investment recommendations made via social media

Jonathan Ritson-Candler

Recent ESMA publication

- ESMA published a short statement on 28 October 2021 to highlight that the EU MAR investment recommendations rules are technology neutral
- The statement is addressed to *"anyone who recommends investments in some way or form* ***via any platform*** *and anyone who makes investment decisions based on investments recommendations* ***done on any platform. This includes social media****"*
- ESMA does not add any new guidance
- ESMA reiterates broad scope of EU MAR and its relevance to those outside the EU and warns of fines and/or referral to public prosecutors

Recent ESMA publication

- ESMA is concerned that investors may be misled where investment recommendations are made without complying with EU MAR's specific requirements on disclosure and transparency
- Ahead of making an investment decision, investors should know and be able to assess:
    - The credibility and objectivity of the investment recommendation
    - Any interests of those making the recommendation

Refresher on what amounts to an investment recommendation

- An **investment recommendation** is information recommending or suggesting an investment strategy
- Explicitly or implicitly
- Concerning one or several financial instruments or the issuers, including any opinion as to the present or future value or price of such instruments
- **Intended for distribution channels or for the public**
  - Distribution channels can be analyst reports, articles, the traditional media, or **social media**

Investment recommendations

- “Information recommending or suggesting an investment strategy” means information:
  a. Produced by an independent analyst, an investment firm, a credit institution, **any other person whose main business is to produce investment recommendations** or a natural person working for them under a contract of employment or otherwise, which, directly or indirectly, expresses a particular investment proposal in respect of a financial instrument or an issuer; or
  b. Produced by persons other than those referred to in point (a), which directly proposes a particular investment decision in respect of a financial instrument
- Note that for (a) and “experts” – more granular disclosure requirements

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HM Treasury’s consultation on regulating buy-now pay-later products

David Berman

Background

- There is currently an exemption from regulation for credit agreements that are interest and fee-free and are repayable in 12 or fewer instalments within a year
- Sharp rise in buy-now pay-later (BNPL) products making use of this exemption since the start of the COVID-19 pandemic led the Woolard Review to recommend BNPL be brought under FCA regulation
- BNPL raises particular concerns about potential consumer harm because many consumers do not view it as a form of credit, there is little “friction” in the process, and there are no affordability checks or other regulatory protections
- Government announced in February 2021 that it would bring BNPL under FCA regulation
- HM Treasury now consulting on how to achieve this - consultation closes on 6 January 2022
- No timeframe yet for next steps, and still unknown how quickly BNPL will be brought into regulation

Key considerations

- Consultation does not set out formal policy proposals at this stage – HM Treasury is gathering thoughts as to how it can best achieve its aims
- There is difficulty in defining an effective regulatory boundary without this becoming overly-complicated or capturing more activities than intended
- **Scope**: HM Treasury wants to avoid casting the net too widely and capturing other types of deferred payment that rely on the same exemption but pose less risk of consumer harm and are seen as a useful way for consumers to manage their finances (e.g., paying for a gym membership or “big ticket” electronics and furniture purchases over the course of 12 months)
- **Proportionality**: HM Treasury also focused on calibrating the BNPL regime so that the requirements are appropriate to the business model and focused on those elements of lending practice that are most closely linked to the potential consumer detriment

Potential regulatory approach

- HM Treasury acknowledges that, as BNPL is interest-free, it is less risky than certain other credit products and it would be disproportionate to apply the full consumer credit regime
- HM Treasury makes the following proposals:

Regulatory requirements	Proposed approach
Credit broking regime	Should not apply to retailers
Financial promotions regime	Should apply to BNPL products
Pre-contractual information	Only FCA rules should apply (not full CCA requirements)
Form and content of credit agreement	Bespoke legislation may be required
Creditworthiness assessments	FCA rules should apply
Arrears, default, and forbearance	FCA rules should apply with adaptations
Access to the FOS	Should be available for BNPL products

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Horizon scanning for the year ahead, following publication of the FCA’s latest Regulatory Initiatives Grid

Rob Moulton

Key initiatives

- LIBOR
    - End date for LIBOR panels in all currencies except USD (end 21)
    - FCA to confirm final decisions on use of new benchmark powers (Q4 21)
- Future Regulatory Framework Review
    - Second HM Treasury consultation on how the UK regulatory framework needs to adapt for the future (Nov 21)
- UK Listings Review
    - Policy Statement on Listing Rule changes (Q4 21)
- Wholesale data
    - Feedback Statement on use and value of data in wholesale markets due (Q4 21)
- Wholesale Markets Review
    - Policy Statement on FCA changes to UK MiFID rules on research and best execution due (Q4 21)
    - FCA consultations on changes that require amendments to FCA rules and guidance planned (Q1 & Q2 22)

Key initiatives

- Diversity and Inclusion
  - Consultation Paper on introducing rules on diversity and inclusion expected (H1 22), followed by a Policy Statement (H2 22)
- Financial Promotions
  - Consultation Paper expected on new gateway for firms approving financial promotions and to strengthen rules for high risk investments (Dec 21)
- Consumer Duty
  - Feedback Statement and second Consultation Paper due (Q4 21)
  - Policy Statement and final rules to take effect (Q3 22)
- Appointed Representatives
  - FCA to consult on policy proposals to enhance its rules for principal firms (Nov 21)
  - HM Treasury to issue a Call for Evidence to gather views on the current Appointed Representatives regime (Nov 21)

Key initiatives

- Operational resilience
  - PRA to consult on introducing an online outsourcing register (H1 22)
  - New operational resilience framework to take effect (31 March 22)
  - Discussion Paper on oversight of critical third parties (TBC 22)
- PRIIPs
  - Policy Statement on changes to the UK framework delayed (Q1 22), with timing for changes to take effect TBC
- Prudential framework for smaller banks
  - First PRA Consultation Paper on a simplified prudential regime for non-systemic domestic banks expected (H1 22)
- IFPR
  - New prudential regime for investment firms will apply (1 Jan 22), with all legislation and FCA rules to be finalised before then

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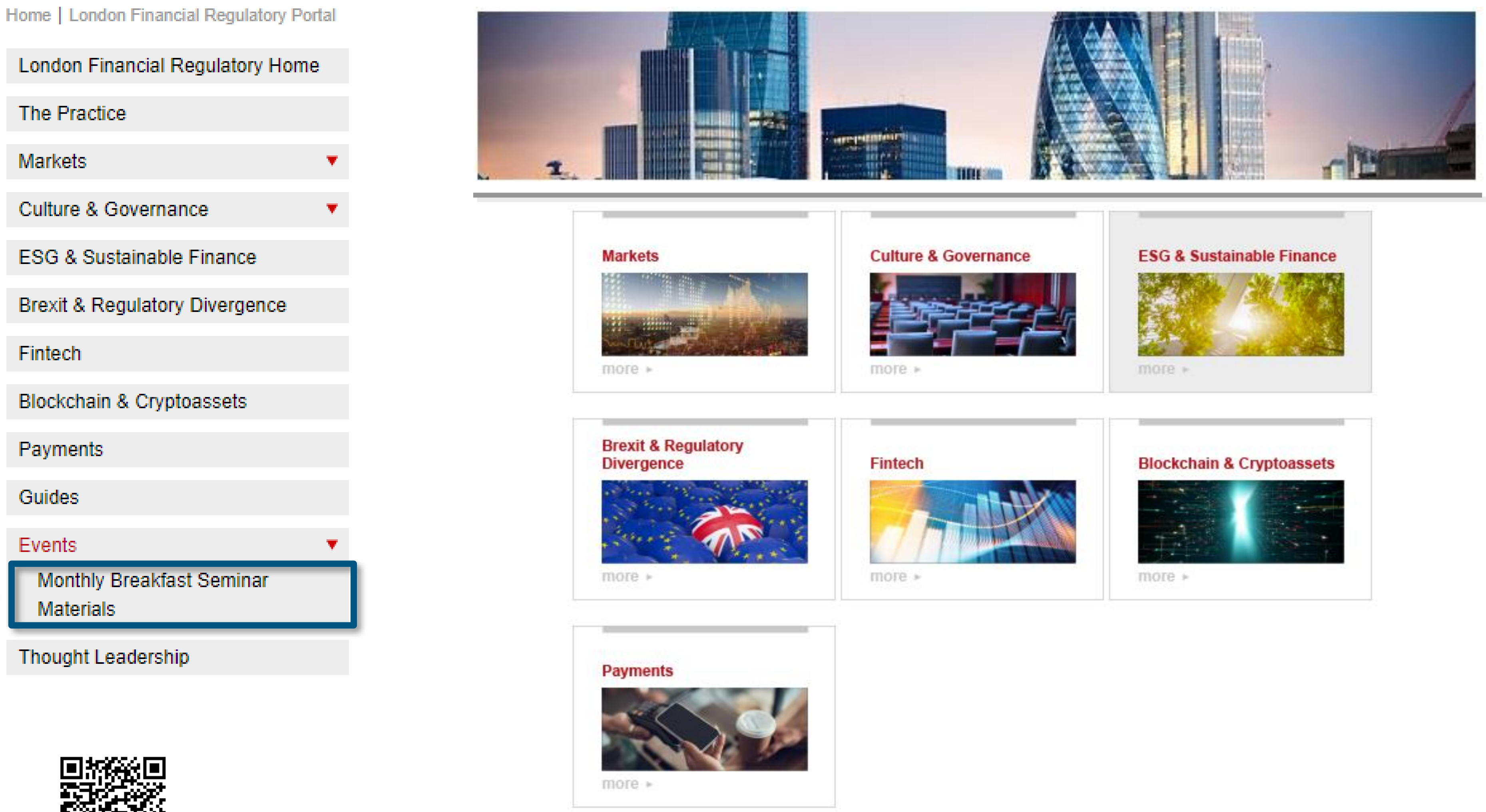

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UK Net Zero Strategy: Understanding the Impact on Key Sectors

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