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13 October 2021

Financial Regulation Monthly Breakfast Webcast

Overview

- The FCA's recent remarks on culture, diversity and hybrid working
- The consultation on the FCA's use of its new cancellation and variation of permission powers
- ESMA's consultation paper on the review of the MiFID best execution reporting framework
- The FCA's Consumer Investments Strategy

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The FCA’s recent remarks on culture, diversity and hybrid working

Jonathan Ritson-Candler

The FCA continues to build on its work on culture

- Recent speech by Sheldon Mills emphasises the FCA's focus on:
  - Measuring and assessing culture
  - Meeting the challenges of hybrid working
  - The role of purpose in a healthy culture
  - Firms taking meaningful steps towards greater diversity and inclusion
  - ESG being a central part of how firms do business
- View in context of recent DP21/2 on Diversity and Inclusion and CP21/24 on enhancing disclosures on D&I for listed companies
- Speech delivered to the IA but can be read across to all firms

➢ Indicated FCA's supervisory priorities

Measuring and assessing culture

- Culture as the primary driver of conduct
  - Firms with healthy cultures are less prone to misconduct
- Measured against 4 drivers: (i) purpose; (ii) people; (iii) leadership; and (iv) governance
- Focus on purpose as a “gravitational force”
  - “Purpose” expressed as a firm’s goals, economic function and values it provides customers
  - Clear purpose helps navigate crises such as the pandemic
  - Bonuses should reflect the firm’s purpose and be linked to financial and non-financial measures
- Focus on people in light of prevalence of hybrid working
  - Benefits: increased wellbeing, productivity and can promote better inclusion
  - Potential drawbacks: isolation, fewer avenues to speak up and lack of oversight

Measuring and assessing culture (cont'd)

- Firms should work to strike the right balance for its people and the firm overall
  - New joiners / younger / more junior staff may need and prefer more time in the office
  - How does this flow through to the mid-level and senior staff who supervise?

➢ FCA will monitor how firms continue to adapt to the new normal and will seek assurance from firms' leaders that they are identifying and mitigating risks as they arise

Remote or hybrid working expectations for firms

- The FCA has recently published its expectations for firms that will continue to operate a hybrid working environment
- Firms will be evaluated by the FCA on a case by case basis
- Firms must be able to prove that remote working does not adversely impact their compliance with regulatory obligations and also prove that satisfactory planning has been undertaken such that:
  - A formalised plan is in place and is kept under review
  - An appropriate culture is in place and maintained
  - Systems and controls (call monitoring, IT functionality, cyber security risks are managed etc.) continue to comply with regulatory obligations
- Staff should be on notice that the FCA has powers to visit any location where work is performed i.e., residential addresses (includes supervisory and enforcement visits)

Continued focus on diversity and inclusion

- D&I of critical importance to the FCA
- Firms should think beyond race, gender and socio-economic background to include broader dimensions of diversity such as sexual orientation and disability
- A focus on D&I will also foster a safe environment where staff are able to speak up – the two go hand in hand
- CP on rules and guidance next year

➢ FCA will increasingly raise D&I questions in engagement with firms

➢ Firms are expected to collect and actively monitor data and take “bold action” where needed

  - Recent letter to RemCos to identify and rectify any pay disparities

Climate change and ESG

- Action on climate change cannot wait
- Firms to drive the changes we need (particularly investment managers)
- ESG, like D&I, must be central to how firms do business

- ESG will increasingly form part of the FCA’s supervisory engagement strategy
- Firms should expect to be challenged on these issues

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The consultation on the FCA's use of its new cancellation and variation of permission powers

Anne Mainwaring

Background

- Report into London Capital & Finance suggested the FCA should be granted stronger powers to more quickly and efficiently remove permissions that are not being used to avoid consumers being misled by firms appearing on the Financial Services Register
- FCA given new power under the Financial Services Act 2021 to vary or cancel permissions where it appears a firm is not using those permissions
- Applies only to FCA-authorised firms (not applicable to PRA-authorised firms), but includes firms in the temporary permissions and supervised run-off regimes
- FCA CP21/28 consults on new FCA guidance as to how it will exercise this power
- Consultation published on 9 September, closes on 29 October

The new power

- New power allows the FCA to cancel and vary permissions at its own initiative where:
  - The firm in question appears to be carrying on no FCA-regulated activities for which it has permission; and
  - The firm has not responded as directed to the FCA’s notices warning of the risk of such action
- Although the FCA is more likely to use the power to cancel permissions, it may vary them when it considers there are matters that require further investigation

Existing power vs new power

- FCA already has a power to remove permissions at its own initiative in various circumstances, but in the case of unused permissions can only do this where a firm has not been using those permissions for a period of at least 12 months
- The new power is intended to allow the FCA to cancel and vary permissions more quickly and efficiently, following a streamlined process
- Firms will have no right to challenge the notices sent by the FCA – they can only avoid cancellation or variation by responding to the notices as directed
- Unlike the existing process, firms will have no right to make representations, and the FCA will not have to share the evidence it is relying on
- Firms will have no right to refer a cancellation or variation decision to the Upper Tribunal. However, firms can make an application to annul the FCA's decision. If this is unsuccessful, the firm may then refer the matter to the Upper Tribunal

Grounds for exercising the new power

- FCA can start the process when it considers that a firm appears to be carrying on no regulated activities
- FCA may form this view where:
  - The firm fails to pay a periodic fee or levy due under the Handbook
  - The firm fails to provide the FCA with information required under the Handbook
  - One or more reports from the firm indicate that it is no longer carrying on regulated activities
  - The firm fails, twice or more, to respond substantively to the FCA’s correspondence when that correspondence requested a response
  - Correspondence to the firm’s address (or an appropriate email address) is returned to the FCA or is otherwise notified to as undelivered
- These circumstances are non-exhaustive

Process timeline

First notice – Warns of the risk of cancellation or variation. Contains directions for the firm (e.g. provide an explanation, confirm the firm is still carrying on regulated activities, provide supporting evidence for this including a senior manager's attestation).

At least 14 days have elapsed and the firm has not responded as directed

Second notice – Will warn of the risk that the firm's permissions will be cancelled or varied. Will specify the proposed date of the cancellation or variation, the proposed extent of any variation, and the steps the firm can take to avoid cancellation or variation.

At least 14 days have elapsed and the firm has not taken the necessary steps to avoid the cancellation or variation

Third notice – FCA's final decision. If the decision is to vary or cancel the firm's permissions, the notice will specify the date this will take effect, and the extent of any variation (if relevant).

Variation or cancellation takes effect

What does this mean for firms?

- Part of FCA's new, more assertive, approach, and ties in with the FCA's "use it or lose it" campaign
- We will wait to see how the FCA uses the power in practice, but firms should note the wide conditions, short timeframe, and lack of detailed process for exercising the power
- Firms should review their permissions to ensure that they are up to date, and any permissions that are not required are removed
- Firms should also consider whether there are any group entities with unused permissions that might be needed

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ESMA's consultation paper on the review of the MiFID best execution reporting framework

Rob Moulton

Current EU (and UK) position

- EU
  - RTS 27 (venue reporting) currently subject to a two year suspension
  - RTS 28 reporting continues
  - ESMA to propose long term reform package
- UK
  - RTS 27 and 28 both (in effect) suspended
  - Short term plan to repeal these requirements entirely

ESMA's proposals – RTS 27

- Rationale behind RTS 27 "continues to apply"
- But too much information is currently produced
- Focused new approach:
    - Information per instrument type, rather than per instrument
    - Reporting in CSV format, with potential EU Single Point of Access
    - Market makers (but not other liquidity providers) to be excluded, with venues to publish information about contribution of market makers instead
    - Certain instruments, such as illiquid bonds, to be excluded entirely

ESMA’s proposals – RTS 27

- New liquidity metrics
  - Total value of all transactions per instrument type
  - Median monetary transaction value per instrument type
  - Costs for a median transaction
  - Bid-offer spread related to the median transaction
  - Access to further information on costs
  - Speed of execution
  - Total number of market makers

ESMA’s approach – RTS 28

- Firms to make separate “top five” disclosures for (1) executed, and (2) transmitted, orders
  - Deletion of requirement to separate out passive and aggressive orders
  - Inclusion of information on payment for order flow

Next steps

- Consultation closes 23 December 2021
- Final legislative proposals due 2022
- UK changes already effective, likely to be formalised shortly with broader MiFID II package

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The FCA's Consumer Investments Strategy

Rob Moulton

Consumer investments: strategy and feedback statement

- Detailed paper (final strategy statement due “early 2022”)
- Key aims:
  - Consumers can get the advice or support they need
  - Consumers only access higher risk investments knowingly
  - Consumers are protected from scams

The £10,000 to invest "dilemma"

- Shift of focus by the FCA given RDR approach
- Detailed analysis of need to increase investment by those with more than £10,000 of investible assets
- Statements include:
    - "Half of UK adults with £10,000 or more of investible assets (8.4 million people) did not receive any formal support to help them make investment decisions"
    - "35% of UK adults with £10,000 plus in investible assets hold them all in cash" [this] "falls to 10% where they have received advice"
    - "Some consumers who have an appetite to invest long-term are failing to consider the opportunities from investing, missing out on potential financial gains"
    - "55% of consumers with more than £10,000 of investible assets held 75% or more of this in cash…many will be missing out on potentially higher returns available from investing"
    - Target – reduce by 20% (8.6 million to 6.9 million) by 2025 consumers who hold over £10,000 of investible assets solely in cash

Financial promotions

- Strengthen financial promotion regime, to protect against high risk investments and scams
    - Proposed gateway for section 21 approvers
    - Altering classification of high risk investments
    - Further segmenting an appropriate market for high risk investments (FPO exclusions)
    - Strengthening the requirements on firms when they approve financial promotions

Defined benefit pensions

- 17% of DB-DC transfer advice was unsuitable, and 28% had significant information gaps

Appointed representatives – “abuses”

- Ongoing (political) review of AR regime
- The FCA intends to address misuse of the regime
  - Firms who use ARs are responsible for proportionally more complaints
  - Increasing supervisory activity aimed at appointers, as well as ARs

Other points

- Focus on pandemic-driven increase in higher risk investments by young adults
- Tackling out-of-date permissions
  - Use it or lose it approach, using new cancellation powers more widely
- Highly statistical approach to judging success
  - 20% reduction in consumers with higher risk tolerance holding over £10,000 in cash by 2025
  - 50% reduction in consumers investing in higher risk investments who indicate a low risk tolerance or have vulnerability characteristics
  - Reduce (from £569 million) losses to investment fraud
  - Stabilise compensation provision by 2025, and target a year-on-year reduction after 2025

Culture – A Framework for Sustainable Change

www.lw.com/thoughtLeadership/culture-framework-sustainable-change

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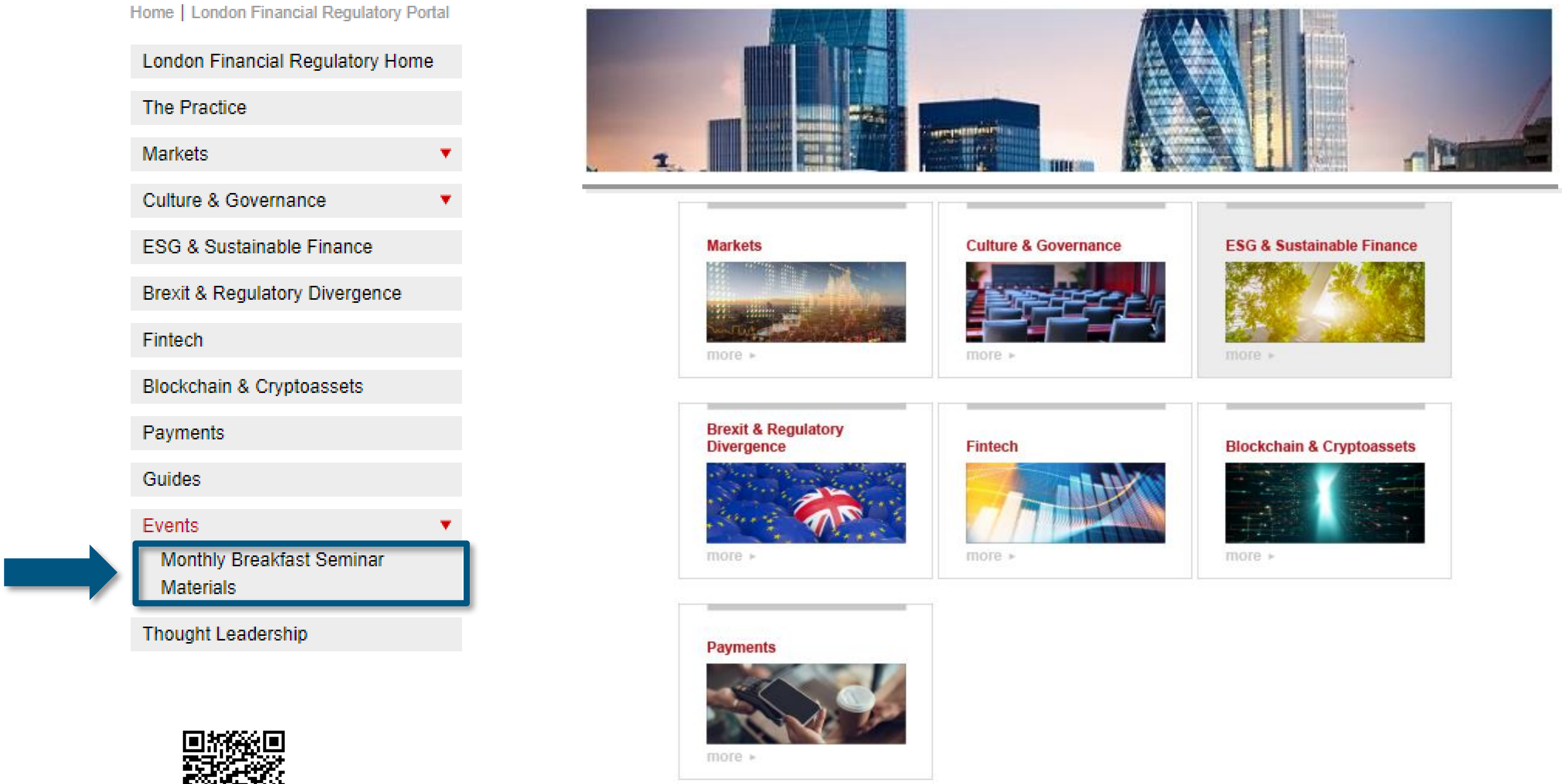

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