

A blue-toned background 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.

LATHAM & WATKINS^{LLP}

5 December 2018

Financial Regulation Monthly Breakfast Seminar

Overview

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- 1 The Brexit “deal” and the FCA’s second Brexit consultation
 - 2 The ESAs' consultation on amendments to the PRIIPs KID Regulation
 - 3 FCA review of firms’ whistleblowing rules
 - 4 The FCA’s report on firms’ cyber and technology resilience
 - 5 The BTMU senior manager fines

A blue-toned background image featuring a financial line chart with multiple data series and a grid of dashed lines.

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The Brexit “deal” (and the statement on financial services in the future relationship between the UK and EU), and the FCA’s second Brexit consultation
Rob Moulton and Anne Mainwaring

Deal or No Deal?

Deal only covers withdrawal for now – the future relationship has only been sketched out

Transitional period:

- Will run until 31 December 2020 (with ability to extend once)
- UK firms will continue to be treated as if the UK is a member of the EU
- EU law will continue to apply (and new EU laws coming in during this period will apply in the UK)
- Participation in EU bodies and agencies will be on a case-by-case basis
- UK will retain access to certain information systems and databases

The future relationship

Outline political declaration in relation to financial services:

- *Commitments to preserving financial stability, market integrity, investor protection and fair competition, while respecting the Parties' regulatory and decision-making autonomy, and their ability to take equivalence decisions in their own interest. This is without prejudice to the Parties' ability to adopt or maintain any measure where necessary for prudential reasons*
- *Commencement of equivalence assessments by both Parties as soon as possible after the United Kingdom's withdrawal from the Union, endeavouring to conclude these assessments before the end of June 2020*

FCA's second Brexit consultation – CP 18/36

- FCA's second consultation on proposed changes to the Handbook and Binding Technical Standards (BTS)
- Consults on Handbook and BTS amendments that relate to draft Brexit Statutory Instruments and policy notes that have been published by the Government since the FCA's first CP on this topic

FCA's second Brexit consultation – key points

- Changes to the SMCR and the Approved Persons Regime (APR) for temporary permission firms
 - Applicable to TP firms that are solo-regulated
 - FCA is proposing to maintain the current requirements that apply to EEA branches under the SMCR and APR throughout their time in the temporary permissions regime (TPR)
 - This means that the additional controlled functions and requirements that apply under the third country regime under the SMCR and APR will only apply once the firm has been fully authorised as a third country branch and has left the TPR
 - Consequently FCA firms utilising the TPR will likely only need two Senior Managers or Approved Persons whilst in the TPR
 - However when such firms get authorised as a third country branch and the TPR ceases to apply, they will be subject to much more extensive requirements

FCA's second Brexit consultation – key points (continued)

- Retail product definitions
 - COBS 4.7 and 4.12 contain restrictions on the promotion of non-readily realisable securities (NRRS) and non-mainstream pooled investments (NMPI)
 - The definitions of NRRS and NMPI currently differentiate between investments and products with a connection to the EEA and those with no such connection
 - For example, securities admitted to official listing on an EEA exchange would not be considered as NRRS but securities listed on an exchange outside the EEA could be
 - The FCA is proposing to depart from the baseline onshoring approach here and instead retain the existing scope of these COBS restrictions (by maintaining the current scope of the definitions of NRRS and NMPIs)
 - This is intended to maintain the current level of consumer protection afforded by these restrictions as well as avoiding disruption for firms and investors following exit day

FCA's second Brexit consultation – key points (continued)

- Appropriateness definition
 - The FCA is taking a similar approach to the rules that apply in relation to when an appropriateness assessment must be carried out
 - Such assessment is only required when an instrument is complex
 - At the moment the list of non-complex instruments includes those admitted to trading on certain EEA markets and UCITS
 - The FCA is proposing to keep the current scope, and therefore instruments traded on EEA regulated markets as well as EEA UCITS will continue to be treated as non-complex
 - The intention is therefore to maintain the scope of the non-complex instruments definition for the purposes of the appropriateness rule as it currently applies

FCA's second Brexit consultation – key points (continued)

- Primary markets
 - HMT has confirmed that the UK's primary markets regime post-Brexit should apply to all issuers that:
 - Have securities admitted to trading on a regulated market in the UK or admitted to listing in the UK; or
 - Are making a public offer in the UK
 - This applies irrespective of the country in which the issuer was incorporated
 - In practice this means that certain issuers will need to have a prospectus approved by the FCA, whereas currently they can rely on a passported document
 - Some issuers will have to make disclosures according to the FCA's rules whereas currently they can do so under the rules of their home state authority

FCA's second Brexit consultation – key points (continued)

- Primary markets
 - The government has committed to continue to treat prospectuses that are valid in the UK pre-exit (including those approved by a competent authority in a different EU member state) as valid for the remainder of the twelve months from their date of approval, including where that includes a period after the UK exits the EU
 - Free float requirement under the Listing Rules – the FCA is proposing to remove the reference to EEA holders in the rules so that holders from any jurisdiction can count towards the free float requirement

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The ESAs' consultation on proposed amendments to the PRIIPs KID Regulation and other key areas of market focus on the impact of the Regulation

Rob Moulton

Background

- PRIIPs KID
 - Overlaps with UCITS KIID
 - Has very wide scope
 - Requires the production of standardised KIDs to assist consumer comparisons
- General agreement this is not working well
 - At ESA level
 - At FCA
 - Although not always at Commission or Parliament level

Regulators' views

- FCA
 - May give UK-specific guidance to reduce scope
 - May give FCA guidance on conflict between KID and the “clear, fair and not misleading” principle
- ESAs
 - Little formal scope to legislate (thanks to Level 1)
 - Thinks Commission review (scheduled for end 2018, now unlikely imminently) will take too long
 - Notes UCITS exemption expires end 2019

ESAs' consultation

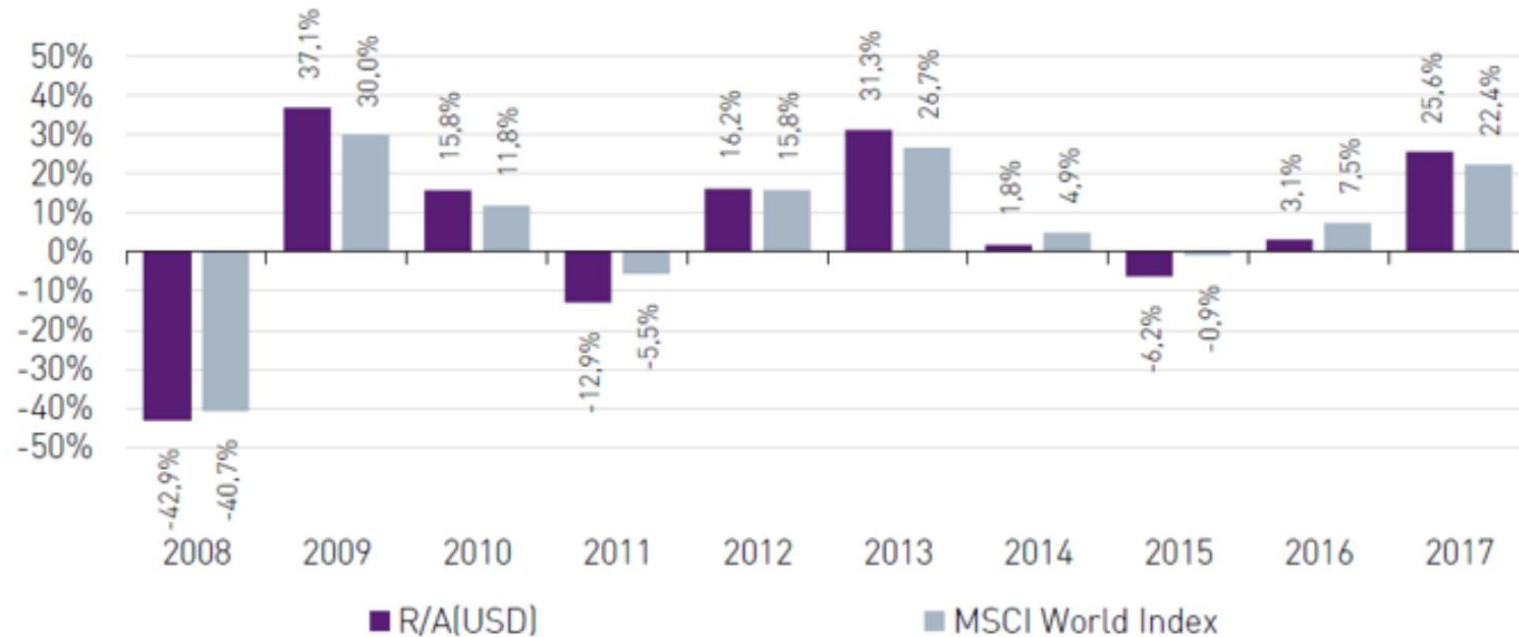
- Expedited consultation process (closes tomorrow)
- No consultation on actual wording of proposed RTS
- Art of the possible...

Past performance

- Does not exist for some products
 - Structured notes
 - Cancelled or redeemed before time horizon
 - CFDs
- Propose dropping past performance in these circumstances
 - Focus on future performance scenarios to aid comparability
 - Amendment to disclosure templates

Actual Past Performance

Past performance is not a guide to future performance



The chart shows the Fund's annual performance in US Dollars for each full calendar year over the period 2008-2017. It is expressed as a percentage change of the Fund's net asset value at each year-end. The Fund was launched in 2006. Performance is shown after deduction of ongoing charges but entry costs and exit costs are not deducted in this chart

Simulated future performance

Market developments in the future cannot be accurately predicted. These scenarios are only an indication of the range of possible returns

Investment <input type="checkbox"/>		1 year	[3] years	[5] years (Recommended holding period)
Scenarios				
Stress scenario	What you might get back after costs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Average return each year	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Unfavourable scenario	What you might get back after costs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Average return each year	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Moderate scenario	What you might get back after costs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Average return each year	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Favourable scenario	What you might get back after costs	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Average return each year	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

This table indicates how your investment could perform over the next 5 years in different market circumstances, assuming that you invest 10.000 EUR. These are estimates based on relevant data from the previous 5 years, and do not take into account the situation where we are not able to pay you. The figures shown include all the costs of the product itself and include the costs of your advisor or distributor. The figures do not take into account your personal tax situation, which may also affect how much you get back.

Other matters

- Market risk measure calculation for regular investment or premium PRIIPs
 - Adapt formula to cover one-off and regular premium
- Auto callable
 - Narrative explanations to early call proposed to go with performance scenarios
- Extension of UCITS KIID exemption
 - Until review of PRIIPs by Commission

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FCA review of firms' whistleblowing rules – key findings David Berman

Context

- Scope and application
- Culture and governance key regulatory priority
 - A strong 'speak-up' culture is a fundamental pre-requisite
- Recent cases – seriousness of whistleblowing failings
- Key expectations
- Key observations

Key expectations

- Responsibility of senior management
- Continuous assessment of whistleblowing arrangements
- Clearly explained whistleblowers' reporting channels (including direct report to the FCA/PRA)
- Victimisation policy and embedded approach to victimisation
- Annual whistleblowing report

Key positive findings

- New rules – improved approach to whistleblowing
- Role of whistleblowers' champion
- Examples of good practice

Areas for improvement

- Key areas for improvement consistent across all firms
- Totality of SYSC18 requirements
- Documented and enhanced whistleblowing investigation process
- Practical arrangements and processes for preventing victimisation
- More detailed training
- Specifically tailored training for managers and other employees
- Annual report – level of detail and analysis



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The FCA's report on firms' cyber and technology
resilience
Stuart Davis

Genesis of the report

- Based on findings from a survey of almost 300 firms, relating to their cyber and tech resilience
- Firms self-assessed their capabilities and the FCA then analysed the responses for each firm, and across sectors
- In the year to October, firms reported a 138% increase in technology outages to the FCA, with 18% of all the incidents reported to the FCA cyber-related
- FCA issued its first fine for cyber-related failings in October 2018 (Tesco Bank)

Key themes

- Governance
 - Smaller firms, or those with a large presence in other jurisdictions, called out challenges in how a cyber strategy is set and its subsequent board ownership
 - Firms reported a lack of Board understanding of cyber risks
 - Management information is often not presented to the Board in a way that can be easily understood and challenged
 - Some Boards struggle to understand that cyber is a global risk not just the responsibility of the IT department

Key themes

- Identification of key assets
 - While firms have established processes to identify their information assets, they are unable to consistently and regularly review and update them as needed
 - A third of firms do not perform regular cyber assessments
 - There is a significant risk that vulnerabilities of unsupported assets are not identified and fixed in a timely way
 - Only 56% of firms say they can measure the effectiveness of their information asset controls
 - Firms may not be addressing the more obvious risks presented to their business and customers

Key themes

- High-risk staff and security culture
 - The FCA was disappointed to see that not all firms operate a cyber-awareness programme
 - Firms described difficulty identifying and managing their high-risk staff (including those who deal with critical and sensitive data), and many did not provide additional cyber training for them
- Detecting attacks
 - Only the largest firms reported that they have automated systems to spot potential cyber-attacks and support their subsequent response

Key themes

- Change management
 - FCA is worried that many firms seem overly confident about their ability to manage flagship IT change programmes and keep their systems up to date
 - Nearly half of firms do not upgrade or retire old IT systems in time
 - 20% of the incidents reported to the FCA over the last year were explicitly linked to weaknesses in change management, making it the most frequent cause of outages
 - The FCA will be doing further work over the coming year to assess the sorts of changes, and poor change management practices, which give rise to the incidents reported

Key themes

- Management of third parties
 - Half of firms said that they do not maintain a comprehensive list of all third parties with whom they do business and which access their systems and data
 - Only 66% of large firms and 59% of smaller firms understood their third parties' response and recovery plans,
 - Only 22% of large firms and 19% of smaller firms explicitly include third parties in their own testing plans

Key takeaways

- The FCA's key areas of focus will be considered in supervisory plans for 2019
- Consider whether you are meeting supervisory expectations in relation to the areas with the most concerns – change management and the management of third parties
- Consider whether enhancements to outsourcing policies and procedures are required
- Read the Bank of England, PRA and FCA joint Discussion Paper on building operational resilience
- Note the Treasury Select Committee enquiry into IT failures in financial services



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The recent fines against senior managers at BTMU
for failure to disclose matters to the PRA in a timely
manner

Andrea Monks

Background

- Investigation by New York Department of Financial Services (DFS)
- First DFS fine – June 2013
 - BTMU fined \$250 million for US sanctions breaches
 - Based on a historical transaction review carried out by PwC at BTMU's request
- Second DFS fine – November 2014
 - BTMU fined \$315 million for pressurising PwC to water down a supposedly objective report
 - BTMU to prevent Mr Kamiya from conducting any of its US banking business in the future
 - Mr Kamiya had previously held a senior role at BTMU in New York
 - Mr Kamiya was Chair of MUS EMEA at the time of publication of the DFS fine

First PRA involvement

- February 2017 – fines for failing to be open and co-operative with the PRA
 - £17.85 million fine imposed on BTMU
 - £8.925 million imposed on MUS EMEA
- BTMU and MUS EMEA did not inform the PRA of the DFS action until after the DFS's public announcement
- Inadequate systems and controls for the communication of relevant information
- Where a firm operates across multiple jurisdictions, PRA expects it to consider appropriately regulatory responsibilities of the firm as a whole

Second PRA involvement

- November 2018
 - £22,700 fine imposed on Mr Akira Kamiya, former Chair of MUS EMEA
 - £14,945 fine imposed on Mr Takami Onodera, former Non-Executive Director of MUS EMEA
- Failure to disclose the possibility Mr Kamiya would be restricted from conducting US banking activities as a result of DFS action
- Mr Kamiya and Mr Onodera breached the PRA's Statement of Principle 4, which required them to deal with the PRA in an open and cooperative way and disclose appropriately any information of which the PRA would reasonably expect notice
- Information about overseas regulatory issues affecting senior individuals is relevant to an assessment of fitness and propriety – PRA would reasonably expect notice
- PRA was hindered in its consideration of whether the DFS matter could have an impact on Mr Kamiya's fitness and propriety and PRA was not able to consider any contingency plans ahead of the public announcement by the DFS

What have we learnt?

- PRA focus on individual responsibility - even where the consequences are harsh
 - Mr Onodera
 - Knew from 6 October of potential implications for Mr Kamiya
 - Believed there was a conflict of duties to PRA / DFS
 - BTMU compliance told him PRA was being notified and he must not report
 - Sought advice from regulatory specialist who told him not to report
- PRA expects individuals to resolve conflicting multi-jurisdictional regulatory responsibilities
 - Individuals must ensure that **“whatever their competing priorities, they promptly and properly consider and discharge their UK regulatory responsibilities”**
- PRA never want to be the last to know

Some recent statistics from FOIA Requests

- Insider dealing
 - 2014/2015 - 2 investigations, 1 resulted in no further action and 1 resulted in regulatory sanctions
 - 2015/2016 - 18 investigations, 13 resulting in no further action, 1 in resulting in regulatory sanctions and 4 on-going
 - 2016/2017 - 91 investigations, 60 resulting in no further action, 1 resulting in regulatory sanctions, and 30 on-going
 - 2017/2018 - 61 investigations, 35 resulting in no further action, and 26 on-going
- Regulatory and criminal investigations
 - 356 active regulatory investigations
 - 167 active criminal investigations



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Questions?