

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 sharp decline.

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7 February 2024

Financial Regulation Monthly Breakfast Seminar

Overview



Recent ESG updates

The FCA's review of historical motor finance commission arrangements

An update on MAR, including Market Watch 76

The FCA's consultation on bond and derivative market transparency

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Recent ESG updates

Ella McGinn

ESG Stewardship & MAR (1)

- FCA has provided views on ESG stewardship in the context of UK MAR in Primary Market Bulletin 46
- Article 10 UK MAR prohibits the unlawful disclosure of inside information, which could include ESG-influenced shareholder voting intentions
- Principles and approach set out in Market Watch 20 and 2009 ABI letter remain relevant to ESG stewardship
- Sir Christopher Gent case not intended to change FCA approach – should not inhibit or stifle high quality engagement between companies and their shareholders, including on ESG topics
- Discussions of a general nature regarding the business and market developments between shareholders and management concerning an issuer are not prohibited under UK MAR – Recital 19 UK MAR

ESG Stewardship & MAR (2)

- FCA unlikely to consider that market abuse rules have been contravened where a shareholder trades based simply on its own intentions and knowledge of its own strategy
- FCA encourages shareholders to evaluate if their ESG stewardship plans are inside information under Articles 8, 14, and 10 of UK MAR – if not inside information, consider voluntary disclosure of ESG voting intentions (e.g. “Say on Climate” resolutions)
- Where collaborative ESG stewardship results in a lasting common policy towards the management of the issuer through the exercise of voting rights, shareholdings may need to be aggregated (DTR 5.2.1R(a))

EU SFDR updates – SFDR Level 1

- The EU Commission has published responses on 22 January 2024 to its targeted consultation on the implementation of SFDR
- Although the SFDR was intended as a disclosure regime, it has been used as a labelling regime in practice – two possible alternative approaches:
 - Build on and develop the distinction between Article 8 and 9 categories to “more clearly define the products falling within the scope of each article”; or
 - Remove Articles 8 and 9 and instead categorise products by type of investment strategy, for instance “promise of positive contribution to certain sustainability objectives” or “transition focus”
- Commission is due to publish a report in Q2 2024

EU SFDR updates – SFDR RTS

- The ESAs have published a Final Report on draft Regulatory Technical Standards under SFDR (4 December 2023)
- Key changes:
 - Changes to the principal adverse impact indicators (PAIs), including additional mandatory and voluntary social PAIs and amendments to existing PAIs
 - Changes to product disclosure templates, including a new “dashboard” summary of key information, ordering of existing questions and new disclosures on greenhouse gas (GHG) emission reduction targets
- EU Commission to decide by 4 March 2023 whether to adopt proposed changes
- Interplay with the SFDR Level 1 review

ESG Benchmarks – EU BMR Review (1)

- Legislative proposals from EU Commission to significantly reduce the benchmarks in scope of the EU Benchmarks Regulation (EU BMR) effective 1 January 2026
- Latest publications from EU legislators on review of EU BMR contain some further developments for ESG benchmarks
 - Council's negotiating mandate on EU BMR (20 December 2023)
 - European Parliament Draft Report on EU BMR proposals (11 January 2024)
- A new obligation on supervised users allowing the use of a benchmark with an ESG claim in legal or marketing documentation only where the administrator has disclosed the relevant information under Article 13 (how methodology reflects ESG factors) and Article 27 (how ESG factors are reflected in the benchmark statement)

ESG Benchmarks – EU BMR Review (2)

- A new label “ESG Benchmark” (in addition to EU CTBs and EU PABs), meaning a benchmark that pursues ESG objectives and that fulfils the ESG disclosure requirements under Article 13(1)(d) and Article 27(2a) – would be in-scope of the revised EU BMR regardless of “significance”
- Administrators would only be able to provide “ESG Benchmarks” if they are authorised, registered or recognised under the EU BMR
- Likely to be common standards on the names of ESG Benchmarks

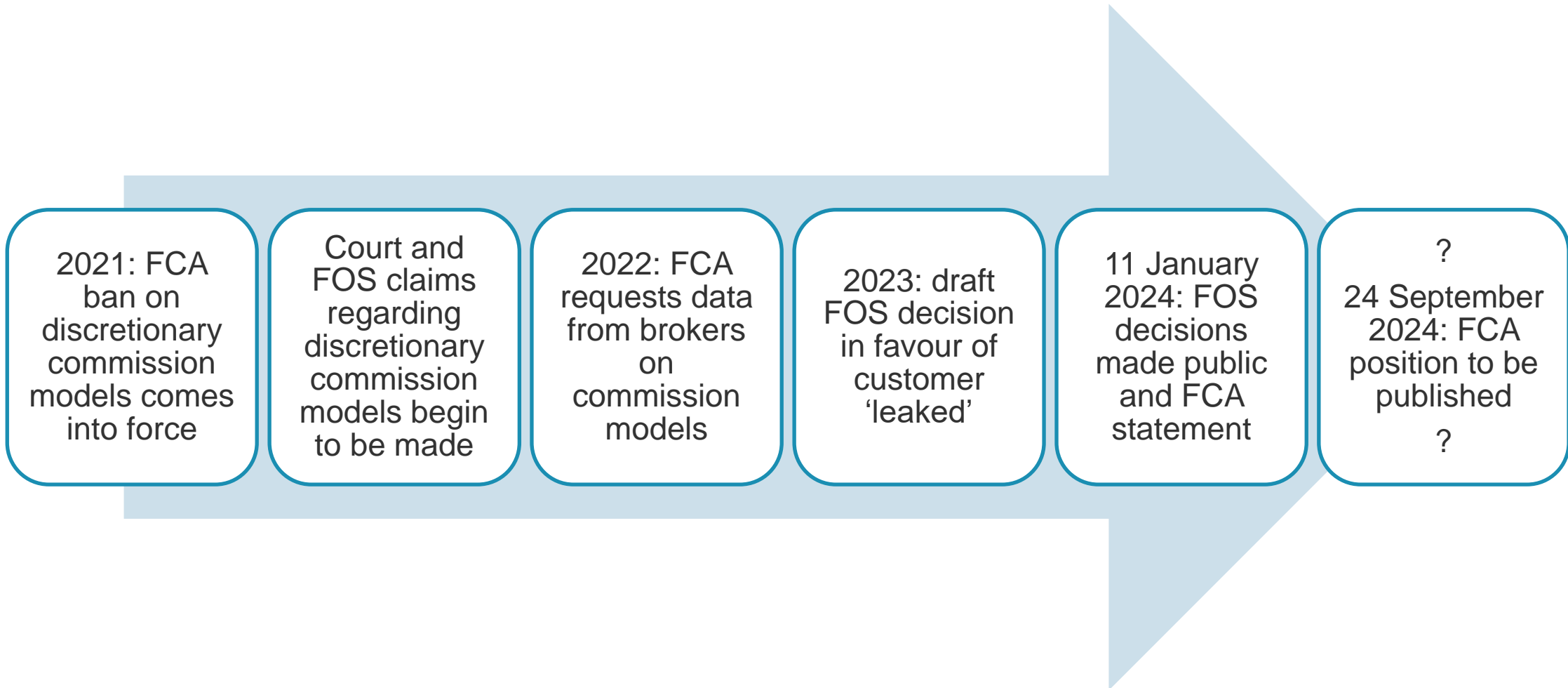


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The FCA's review of historical motor finance commission arrangements

Becky Critchley

Timeline



Financial Ombudsman Service

- 11 January 2024 - two decisions in favour of customers who brought motor finance commission claims against lenders
- Key points:
 - All forms of discretionary commission models are at risk
 - Inadequate commission disclosures
 - Additional conflicts disclosures required
 - Notable disclosure failings by brokers highlighted
- Redress:
 - Difference between the interest the customer in fact paid and the interest they would have paid under the lowest interest rate available
 - 8% interest per annum on each sum overpaid
- No broker decision, yet:
 - Indications are it is likely to be in customer's favour
 - No indication of redress calculation – commission or interest?

FCA initiatives

- FCA to launch market wide ‘diagnostic work’
- Sample of firms will have to contribute by allowing third party expert access and assistance
- Complaints handling rules altered to allow FCA time to reach a conclusion
- FCA is focussed on:
 - Whether firms owe redress to a large number of customers
 - Providing appropriate redress from firms in an orderly, consistent and efficient manner
 - Protecting market integrity and the effective functioning of the motor finance market

Next steps

- Firms will need to consider:
 - Their approach to complaints
 - Resourcing for complaints
 - Resourcing if required to participate in diagnostic work
 - The adequacy of existing commission arrangements and disclosures

Timing

- Diagnostic work to begin imminently
- FCA announcement on approach to market-wide redress expected around 24 September 2024 (or an extension to diagnostic work)
- FOS decisions will continue in the interim

Broader read across?

- On similar fact patterns, would this be confined to motor finance?
- Quality of disclosures generally
- CMC attention



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An update on MAR, including Market
Watch 76

Jonathan Ritson-Candler

Market Watch 76

- Flags the FCA's observations and concerns relating to “flying and printing”
 - *Flying prices*: involves a firm communicating to its clients, or other market participants, via screen, instant message, voice or other method, that it has bids or offers when they are not supported by, or sometimes not even derived from, an order or a trader's actual instruction
 - *Printing trades*: involves communicating, by one of the above methods, that a trade has been executed at a specified price and/or size, when no such trade has taken place
- Cross refers back to Market Watch 57 (November 2018) which in turn links back to Market Watch 48 (June 2015)
 - FCA has previously expressed concern regarding the advertising of trade volumes (which are potentially misleading) and, more recently, advertising prices which are not supported by a client order or trades which are fictitious (which is also misleading)

Market Watch 76

- The FCA is concerned that if false prices and/or trading activity are advertised to the market, then there is a risk that trading decisions may be made based on misleading information. This could cause market participants financial harm, and would undermine the integrity of the market
- FCA observed that following previous Market Watches, some firms responded by changing their practices; namely, by making a clear distinction between a price which is supported by an order or a trader's bid or offer and one which is indicative only
- MW 57 stronger than MW 48 that it considers this practice highly likely to be market manipulation and reminding firms to have policies, procedures, training and monitoring to prevent flying and printing

Market Watch 76

- FCA reiterates it sees this as an ongoing issue in several markets
- Is concerned that firms' management is failing to recognise the risks of flying and printing and to implement appropriate surveillance and mitigation
- FCA has seen entering of prices in lit markets to generate orders in dark markets

Market Watch 76

- Reminder for firms to
 - Ensure policies and compliance manuals prohibit the behaviour and that traders provide annual attestations
 - Senior management to effectively communicate firm's expectations and culture
 - Ensure training covers this practice and the potential consequences
 - Ensure surveillance procedures identify and report flying and printing
 - Ensure disciplinary procedures are clear and consistent and that commercial interests are not drivers of outcomes

Pre-closed period calls

- Market practice of issuers having calls with analysts who cover the stock ahead of closed period (e.g., ahead of end of year results)
- Reiterates information already in the public domain ahead of issuer entering into closed period and not being able to liaise with analysts
- Recent press attention on share price moves following these calls and whether inside information is being disclosed or discerned by participants (given they ordinarily only discuss existing public information)
- Some calling for additional guidance from regulators regarding practices around such calls including publication of full transcripts following calls
- ESMA provided brief response saying it has not issued guidance and that it is for NCAs to oversee their markets
- No indication as yet as to whether the FCA will engage or say anything publicly

ASIC pre-hedging

- The Australian regulator, ASIC, has recently issued a fine for pre-hedging activity and issued a Dear CEO letter setting out its expectations
- “Pre-hedging” involves a broker acting as principal, undertaking a transaction to hedge the risk that it anticipates it will acquire from a future client transaction
- Exposed to risk of insider dealing if the broker were to use the information received from the client to trade on their own account, including potentially trading against the client
- May also have an anti-competitive effect as between brokers if the pre-hedging activity affects the market price of the instruments and impacts the price the other competing firms showing to the client before concluding the request for a quote

ASIC pre-hedging

- Divergent market views on pre-hedging in the EU and UK – as noted in ESMA’s 2020 review of MAR and subsequent 2023 feedback report on pre-hedging
- ASIC Dear CEO letter acknowledges utility of pre-hedging but sets out suggested approach to mitigate conflicts of interest and risk of market abuse
 - Robust policies and procedures
 - Disclosure to clients (ahead of and following pre-hedging)
 - Obtain express and informed client consent
 - Monitor and minimise market impact
 - Ensure inside information is shared on a need to know basis only
 - Maintain effective surveillance tools
 - Record details of pre-hedging approach and resulting activity

A blue-toned background featuring a financial line chart with multiple data series and a grid. The chart shows various peaks and troughs, suggesting market volatility. The overall aesthetic is professional and data-driven.

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The FCA's consultation on bond and derivative market transparency

Rob Moulton

Background

- Part of the Wholesale Markets Review
- Follows prior proposals on equity markets
- This paper covers pre and post trade reform for bonds and derivatives, plus a new Systematic Internaliser definition for all asset classes

Why make changes?

- Current system too costly, with too much irrelevant information, because:
 - The scope is too broad
 - The calculations capture low liquidity instruments
 - The waiver regime is too complex
 - Market data is therefore too patchy (and often unnecessary)

Key drivers behind the policy

- Only focus on sufficiently liquid assets:
 - Sovereign bonds, corporate bonds, and a subset of cleared derivatives (“Category 1 Instruments”)
- Rebalance from pre in favour of better post-trade data
- Adjust SI regime to fit alongside these changes

Changes in overview

- Pre-trade transparency will only be required from venues
 - Adequate information on current bid and offer, actionable IOIs and depth
- Post-trade transparency in OTC markets restricted to Category 1 Instruments only
- Post-trade transparency for on-exchange trades required for Category 2 Instruments (derivatives and structured finance products – excluding emissions)

Scope of post-trade regime for OTC markets

- Bonds
 - If traded on a Trading Venue
- Derivatives
 - Only those subject to the clearing obligation
 - FCA considering adding FX
- CDS
 - iTraxx Europe Main
 - iTraxx Europe Crossover

Scope of post-trade regime for OTC markets

- Interest rate swaps
 - Fixed-to-float EURIBOR (28 days to 50 years)
 - OIS SONIA (7 days to 50 years)
 - OIS SOFR (7 days to 50 years)
 - OIS €STR (7 days to 3 years)
 - OIS FedFunds (7 days to 3 months)

Pre-trade waivers

- Remove waivers for RFQ and voice transactions (as no pre-trade transparency will apply to them anymore)
- New waiver for negotiated orders
 - So long as executed within the spread

Deferrals

- Sovereign bonds – based on issuance, size, country of issuer, and maturity
- Corporate bonds – based on currency, issue size, and rating (investment grade only)
- OTC derivatives – based on tenor and liquidity
- CDS – the two iTraxx indices
- Two models proposed
 - Two triggers ending with full transparency
 - Simpler one-trigger regime with limited final transparency

Exemptions

- Inter-fund transfers
- Give-ups and give-ins (note improved definition compared to equity consultation)
- Trades on the default of a CCP member
- Inter-affiliate trades

- Follows approach in equity market paper

Post-trade information fields and flags

- Lots of technical changes
 - Remove ACTX, NPFT, ILQD, SIZE
 - Add PORT
 - Amend fields e.g. price
- Follows approach in equity market paper

SI – definition

- Move from qualitative to quantitative definition
- FCA rejected calls to retain the opt-in (thanks to the introduction of the Designated Reporter Regime which makes this unnecessary)
- Definition
 - Carried on in line with rules and procedures in an automated technical system, such as an electronic execution system, which is assigned to that purpose
 - Available to counterparties on a regular or continuous basis
 - Held out as being carried on by way of business, in a manner consistent with Article 3 of the Business Order in respect of the relevant financial instrument. (On this point, firms may refer to our new proposed guidance in PERG 13.2 Q10a for guidance on meaning)

Recent Thought Leadership



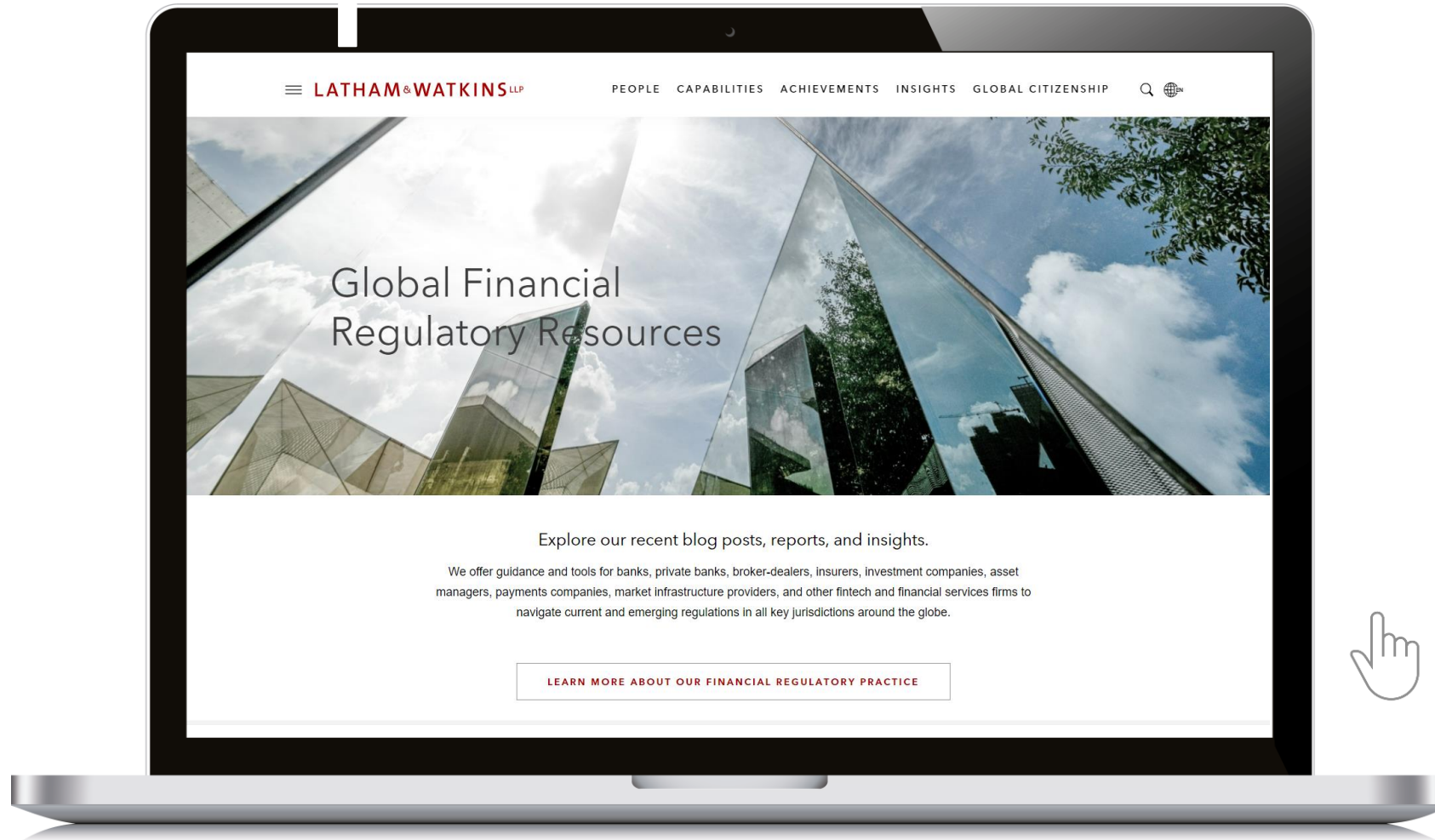
Monthly London Webcast Materials

Each month the UK and European Financial Regulatory lawyers at Latham & Watkins host a presentation and discussion covering recent changes to financial services regulation.

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