



LATHAM & WATKINS

13 July 2022

# Financial Regulation Monthly Breakfast Seminar

# Overview



The UK's latest approach to retail protection: HMT on buy now, pay later; the FCA's Dear CEO letter on cost of living forbearance

Investment Research and Payment for Order Flow: A US update

Improving equity secondary markets (FCA CP22/12)

ESG update: The FCA's next steps



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The UK's latest approach to retail protection: HMT  
on buy now, pay later; the FCA's Dear CEO letter on  
cost of living forbearance  
Becky Critchley

# HMT future regulation of buy now, pay later

- Recap:
  - Exemption in article 60F(2) RAO
  - Woolard Review
  - February 2021 government announcement of intention to regulate interest free Buy-Now Pay-Later ('BNPL') products
  - 21 October 2021 HMT consultation on a proportionate approach to BNPL regulation
  - 20 June 2022 HMT response to consultation



# HMT future regulation of buy now, pay later

- What is in scope:
  - BNPL agreements
  - Other forms of 'short-term interest-free credit' ('STIFC') provided by third party lenders
  - *Possibly* STIFC provided directly by merchants where offered online or at a distance – further comments by **1 August 2022**
  - 'Proportionate' regulatory controls

# HMT future regulation of buy now, pay later

- What is out of scope:
  - Invoicing
  - Interest-free agreements which finance contracts of insurance
  - Charge cards
  - Trade credit
  - Employer / employee lending
  - Credit broking of BNPL and STIFC agreements by merchants (unless domestic premises suppliers)

# HMT future regulation of buy now, pay later

- What does 'proportionate' look like:
  - Application of the financial promotions regime, rules TBC
  - No CCA pre-contractual disclosure, but an FCA regime TBC will apply
  - New rules TBC on the form and content of BNPL and STIFC agreements
  - s61 CCA on improperly executed agreements will apply
    - Improperly executed agreements are unenforceable by the lender without a court order
  - Rules on creditworthiness assessments will apply, any tailoring TBC
  - Expectation for timely credit reporting
  - FCA rules on the treatment of customers in default or arrears will apply, any tailoring TBC
  - CCA requirements on post-contractual information will apply, any tailoring TBC
  - s75 CCA will apply
  - Access to the FOS

# HMT future regulation of buy now, pay later

- Timing:
  - STIFC comments by 1 August 2022
  - Draft legislation end 2022
  - Secondary legislation laid before Parliament mid-2023
  - FCA consultation mid-2023?



# Dear CEO letter on cost of living forbearance

- 16 June 2022 - FCA [letter](#) to lenders to support consumers struggling with the cost of living and [webpage](#)
- *‘The financial services industry has a significant role in helping consumers manage their finances – and it should expect us to pay close attention to how they do that over the next few months’*
- Key points:
  - COVID 19 ‘Tailored Support Guidance’ is also relevant here
  - Particular emphasis on vulnerability and FCA’s previous Vulnerable Customer Guidance
  - The importance of tailoring
  - Relevant to new and existing customers
  - BNPL firms ‘encouraged’ to follow the guidance

# Dear CEO letter on cost of living forbearance

- Wider industry read-across
- What can firms do:
  - Consider how the cost of living increase may impact your customers
  - Review current policies and processes
  - Assess headcount
  - Ensure forbearance is 'tailored'
  - Enhance training, particularly for call centre staff
  - Review and react to FCA's findings on how firms are embedding the 2021 vulnerable customer guidance

# Cost of living – other recent publications

- FCA [press release](#) urges consumers to seek help and “contact your lender”
- FCA [research paper](#) ‘Borrowers in Financial Difficulty’
- FCA updated [webpage](#) ‘Dealing with financial impact of rising costs of living’
- CMA [speech](#) by Sarah Cardell, interim CEO, ‘Maximising our relevance and impact in a changing world’
- FCA [webpage](#) “Ensuring the fair treatment of customers in vulnerable circumstances”



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Investment Research and Payment for Order Flow:  
A US update  
Marlon Q. Paz and Steve Wink

# Investment Research – US Perspective

- Research is a vital part of the U.S. National Market System

***“It is, therefore, the [U.S. Securities and Exchange] Commission’s premise that broad-based securities research and its prompt and fair dissemination to large and small investors is indispensable to an efficient system of securities markets”***

[Future Structure of Securities Markets, 37 Fed. Reg. 5286 \(Mar. 14, 1972\)](#)

***“Recognizing the value of research in managing client accounts, however, Congress enacted Section 28(e)<sup>15</sup> of the Exchange Act to provide a safe harbor that protects money managers from liability for a breach of fiduciary duty...”***

[Commission Guidance Regarding Client Commission Practices Under Section 28\(e\) of the Securities Exchange Act of 1934, 71 Fed. Reg. 41978 \(Jul. 24, 2006\)](#)

- IOSCO – “Information is the lifeblood of modern capital markets...research analysts play an important role in the relationship between companies and investors, both retail and institutional” [Technical Comm., Report on Analyst Conflicts of Interest, International Organization of Securities Commissions \(2003\)](#)
- US regulators also recognise that the provision of investment research may have associated conflicts of interest that may create incentives for firms providing research and research analysts to issue biased research

# High Level Review of US Legislative and Regulatory Measures Addressing Research Analyst Conflicts

- Global Research Analyst Settlement
  - Wide-ranging reforms that were designed to insulate sell-side analysts from investment banking pressure and make research more objective
  - Examples: (i) required to physically separate research and investment banking departments; (ii) prohibit analysts from participating in efforts to solicit investment business; (iii) create and enforce communications firewalls between analysts and investment bankers; (iv) not base analysts' compensation directly or indirectly on investment banking revenues or input from investment banking personnel
  - Many settlement provisions apply only in respect of a research report that is both (i) prepared by the firm, and (ii) that relates to either (A) a U.S. company, or (B) a non-U.S. company for which a U.S. market is the principal equity trading market
  - 2010: District Court modifies the settlement to permit chaperoned research analyst and investment banking participation in joint due diligence sessions under certain circumstances



# High Level Review of US Legislative and Regulatory Measures Addressing Research Analyst Conflicts

- Sarbanes-Oxley - Directs adoption of rules reasonably designed to address nine general topic areas relating to research analysts' conflicts of interest
- Regulation AC requires
  1. all of the views expressed in the report accurately reflect the analyst's personal views about any and all of the subject securities or issuers; and
  2. no part of the analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by the analyst in the report
- FINRA Debt and Equity Research Rules (Rule 2241 and Rule 2242)
  - mandates separation between research and investment banking, proscribes conduct that could compromise a research analyst's objectivity, and requires specific disclosures in research reports and public appearances

# High Level Review of US Legislative and Regulatory Measures Addressing Research Analyst Conflicts

- JOBS Act
  - Section 105(b), prohibits any rule or regulation in connection with an IPO of an EGC that: (1) restricting, based on functional role, which associated persons of a broker-dealer or FINRA member may arrange for communications between a securities analyst and a potential investor, or (2) restricting a securities analyst from participating in any communications with the management of an EGC that is also attended by any other associated person of a broker-dealer or FINRA member whose functional role is other than as a securities analyst
  - Section 105(d), address the quiet periods imposed by the SRO rules on research relating to EGCs

# Impact of MiFID II on Research Coverage

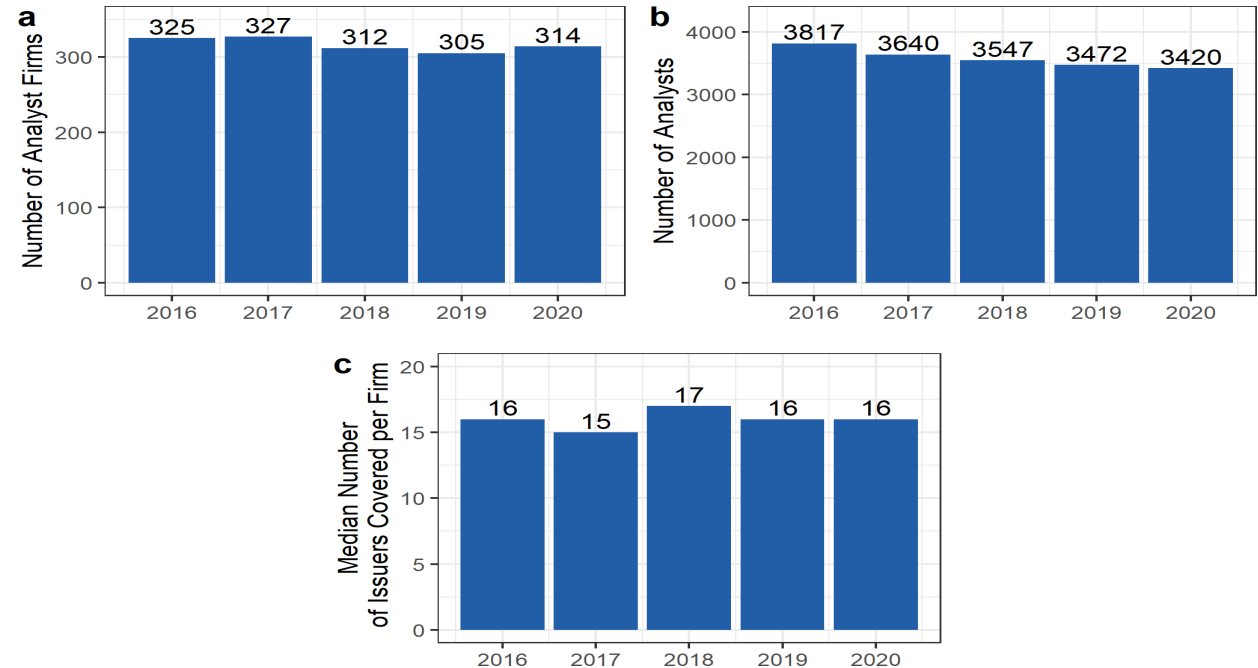
- The United States implemented several legislative and regulatory measures to address these conflicts of interest, with a view to improving the quality of research and restoring public confidence
- In reporting to Congress, the SEC has taken notice of legislative and regulatory measures outside of the United States, [MiFID II](#) in particular
- On February 18, 2022, the SEC issued a report noting the effect of these initiatives on the availability of research coverage for small issuers

# Impact of MiFID II on Research Coverage

- Impact of domestic legislative and regulatory efforts on research coverage generally appears to be inconclusive, unclear, or difficult to isolate and individually measure
- After MiFID II was implemented, both asset managers paying for research and research providers have tried to remain competitive in the EU and US markets
- As a result of MiFID II
  - There has been a trend towards asset managers paying for research from their own resources
  - Many asset managers decreased their research budgets and the number of their research providers, but it is unclear whether this was due to the legislation since this downward trend existed before MiFID II went into effect
  - Research providers competed over research prices that reduced research costs, but this has disadvantaged small research providers more so than large research providers

# SEC Report on Investment Research Trends

- Despite the difficulty of identifying causal linkages, the SEC’s analysis of data (from 2016 to 2020) concerning research coverage indicates certain trends:
  - Number of analysts providing research coverage has declined in recent years.
  - Percentage of issuers receiving research coverage has been relatively consistent during most of this time
  - Small issuers are less likely than large issuers to be covered by research
  - Availability of research coverage and the number of analysts covering an issuer correlate with market capitalisation



**Recommendations:** (1) “continue to monitor” (2) “engage with global regulators and industry participants to better understand any developments in the research marketplace”

# Specialised Topics Impacting Investment Research

- Investment Research and SPACs/De-SPACs
- Research & Social Media
- Investment Research and ESG



# Payment For Order Flow

- ***“Right now, there isn’t a level playing field among different parts of the market: wholesalers, dark pools, and lit exchanges. Further, the markets have become increasingly hidden from view”***

[US SEC Chair Gary Gensler, “Market Structure and the Retail Investor:” Remarks Before the Piper Sandler Global Exchange Conference](#)

- SEC is reviewing:
  - Minimum Pricing Increment
  - National Best Bid and Offer
  - Disclosure of Order Execution Quality
  - Best Execution
  - Order-by-Order Competition
  - Payment for Order Flow, Exchange Rebates, and Related Access Fees
- H.R. 4617, to require the Securities and Exchange Commission to carry out a study on payment for order flow, to require the Investor Advocate of the Commission to provide recommendations on payment for order flow, and for other purposes

A blue-toned background image featuring a financial line chart with multiple data series and a grid. The chart shows various peaks and troughs, with some lines appearing thicker than others. The overall aesthetic is professional and data-oriented.

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Improving equity secondary markets (FCA CP22/12)  
Rob Moulton

# What is (and is not) covered?

- CP is part of the Wholesale Markets Review
- Only covers areas where existing rules can be changed (and where legislative amendments in the new Financial Services & Markets Bill are therefore not required)
  - Separate consultation related to FSMB will follow
- Proposals pay (nodding) regard to ongoing EU reforms

# Post trade

- FCA proposes to maintain the exclusion for non-transaction reported trades
- Improved definition of cross-fund transfers by an asset manager will exclude more trades
- Give-ups – new amendment will exclude RFMD give-ups, on the basis they are not price forming (?). Definition is
  - *Where an investment firm executing a trade passes it to, or receives it from, another investment firm for the purpose of hedging a derivative position that it has committed to enter into with a client*
- New exemption for inter-affiliate transactions
  - *Inter-affiliate transaction means a transaction between entities within the same group carried out exclusively as part of centralised booking for intra-group risk management purposes*

# Post trade

- Transactions which are OTC, but are reported to a venue (e.g. under LSE Rule 3000) will be deferred until the opening of the next trading day
- A number of changes will be made to the flags (wider use of NPFT and TNCP), use of SIZE LIQD RFPI (as rarely used) and DUPL (as it is rare for there to be duplicates)
- Trade reporting – firms can elect (notification to FCA) to be a reporter whether they are an SI or not (with the seller reporting where both are registered as reports)

# Pre-trade Transparency

- Under reference price waiver, reference prices from outside the UK can be used (although tick size calculations will remain driven by UK venues)
- OMF waivers – the £10,000 minimum size limit will be removed, and venues will be allowed to fix OMF size criteria (if at all)



# Tick size

- Trading venues are to set minimum tick sizes based on liquidity in most liquid market
- Venues can use overseas markets when doing so, and match overseas tick sizes (e.g. USD 0.01c for many US shares)

# Operational resilience

- FCA proposes carrying out more work before providing guidance on outages

# RSP

- FCA does not yet make new proposals, but will keep the working of this market under review (in particular in respect of best execution)

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 sharp drop. The overall aesthetic is professional and data-oriented.

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ESG update: The FCA's next steps  
Nicola Higgs and Anne Mainwaring

# FCA's potential next steps for ESG integration in capital markets

- FCA published [FS22/4](#) setting out the feedback received on CP21/18 in relation to dealing with potential harms relating to ESG-labelled debt instruments and ESG data and ratings providers
- FS22/4 is accompanied by Primary Markets Bulletin 41 (see further below) which sets out further detail of the FCA's planned approach

# ESG-labelled debt instruments

- With the growth of ESG-labelled debt, FCA have seen examples of green bond frameworks in which the issuer advertises certain outcomes and makes certain commitments, especially around the allocation of the proceeds of the bond and the governance around the allocation of such proceeds
- In some circumstances, while prospectus disclosure clearly states an issuer is not obligated to use the proceeds in a specific manner, accompanying documents imply a stronger commitment
- Policy action: FCA reminds issuers, their advisors and other relevant market participants of their existing obligation to ensure any advertisement issued in relation to an offer to the public or admission to trading on a regulated market is not inaccurate or misleading, and is consistent with the information contained in the prospectus



# ESG-labelled debt instruments

- FCA also encourages issuers and their advisors to consider relevant industry standards (such as the ICMA Principles and Guidelines for green, social, and sustainability bonds) when issuing ESG labelled debt instruments
- FCA also encourages issuers to consider relevant industry standards (such as the ICMA Guidelines for Green, Social, Sustainability and Sustainability Linked Bonds External Reviews) when selecting their Second Party Opinion ('SPO') providers and verifiers
- Verifiers and SPO providers are themselves encouraged to consider voluntarily applying these guidelines - in particular the ICMA Guidelines encourage such providers to consider using recognised standards and codes, including those developed by the International Audit and Assurance Standards Board IAASB and the International Ethics Standards Board for Accountants IESBA

# ESG data and rating providers

- FCA sees a clear rationale for regulatory oversight of certain ESG data and rating providers
- The design of any regulatory approach would be based on the main elements of the IOSCO recommendations on ESG data and ratings
- Such an approach would aim to:
  - Enhance transparency of ESG ratings and data products and their methodologies, assisting users in interpreting what they aim to measure and how, and
  - Promote strong governance, conflicts management, and systems and controls to underpin data and rating products and give the market confidence that they are objective, independent and free from bias, determined as the result of a systematic process, and of reliable quality

# ESG data and rating providers

- Given the potential lead time before any such regime could come into force, FCA plans to work in the interim with the Treasury to convene, support and encourage industry participants to develop and follow a voluntary Code of Conduct based around IOSCO's recommended key regulatory outcomes

# Consultation: Review of Guidelines on MiFID II product governance requirements (ESG aspects)

- When considering the target market for products with sustainability factors, ESMA expects firms to consider the following elements within the target market category of clients' objectives and needs:
  - The minimum proportion of the product that is invested in environmentally sustainable investments as defined in the Taxonomy Regulation;
  - The minimum proportion of the product that is invested in sustainable investments as defined in SFDR;
  - Whether, where relevant, the product has a focus on either environmental, social or governance criteria or a combination of them;
  - Which principal adverse impacts (PAI) on sustainability factors are considered by the product, including quantitative or qualitative criteria demonstrating that consideration. Firms can use the categories presented in the SFDR RTS (instead of an approach based on each PAI indicator) such as “emissions”, “energy performance”, “water & waste”, etc.

# RESCHEDULED Non-Financial Misconduct in Financial Services and Parliament

WEDNESDAY

**2 November 2022**

8:30 – 10:30 a.m. BST

**Drapers' Hall**  
Throgmorton Avenue  
London, EC2N 2DQ

**REGISTER**

Join us for a lively discussion based on real-life case studies as we address the complexities of non-financial misconduct and consider lessons to be learned from the continuing 'party-gate' saga.

This session will explore non-financial misconduct's relevance within the financial services context, recent legal developments, and ways to establish practical boundaries.

We will be joined by Beth Rigby, Political Editor at Sky News. Beth has worked as a political journalist for nearly a decade, covering two general elections, the Scottish independence and EU referendums, and all the twists and turns of Brexit.

## Speakers



**[Beth Rigby](#)**

*Political Editor*  
Sky News



**[David Berman](#)**

*Partner*  
London



**[Jon Holland](#)**

*Partner*  
London



**[Rob Moulton](#)**

*Partner*  
London



**[Charlie Bowden](#)**

*Associate*  
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**[Nell Perks](#)**

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[FCA Identifies “Clear Rationale” for Regulating ESG Data and Ratings Providers](#)

[European Parliament and Council Reach Political Agreement on CSRD](#)

[A Practical Guide to Market Conduct for Investment Managers](#)

