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14 June 2023

# Financial Regulation Monthly Breakfast Seminar

# Overview



The FCA's engagement papers on the future UK prospectus regime

The EU's Retail Investments Package, focusing on changes to MiFID II and PRIIPs

Global regulators and their reaction to the recent banking sector turbulence



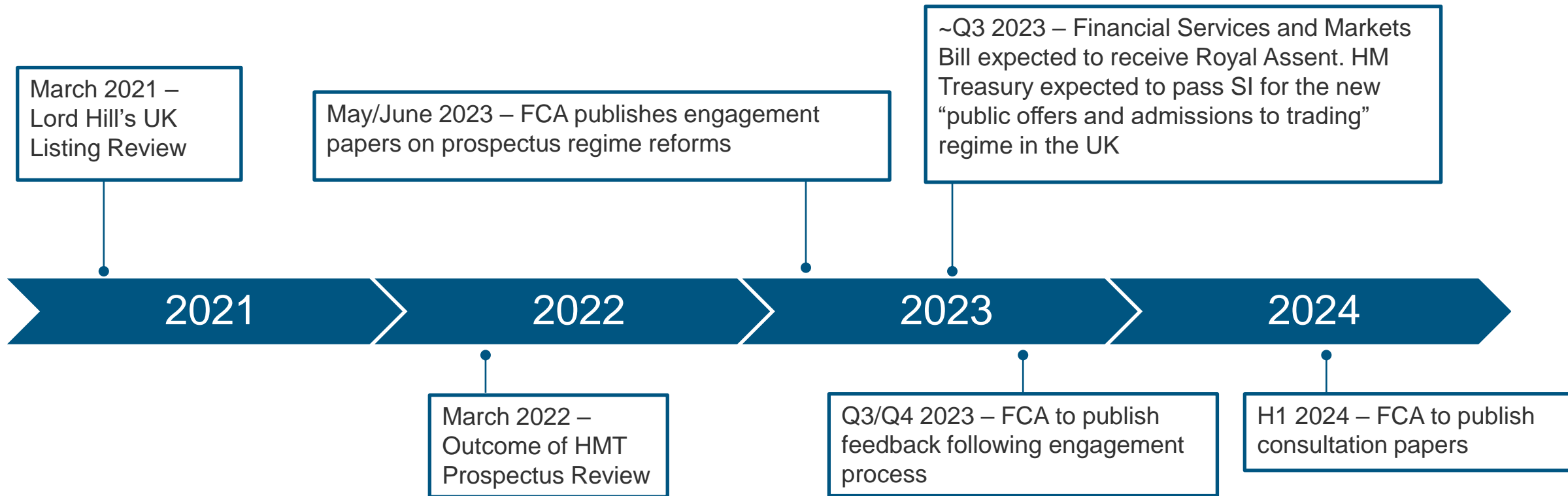
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The FCA's engagement papers on the future UK  
prospectus regime  
Chris Horton

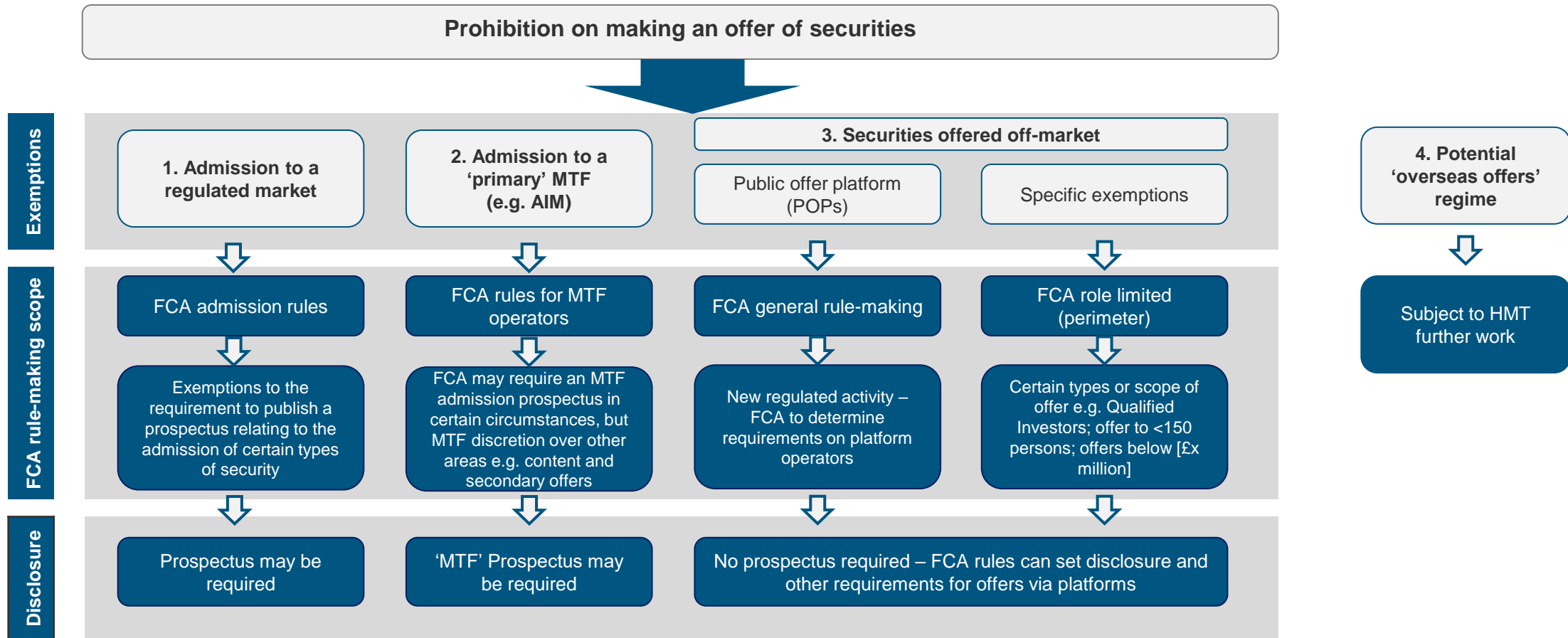
# FCA Thematic Engagement Papers on Prospectus Reforms

- In May 2023, the FCA launched a process of engagement and dialogue on how the UK's future prospectus regime could operate
- The FCA's first thematic engagement papers, published on 18 May, aim to solicit discussion and feedback on:
  - Whether or how to set prospectus requirements for issuers seeking admission to trading on UK regulated markets
  - Whether or how to set prospectus requirements for issuers raising further capital
  - How forward-looking information should be covered in prospectuses
  - How to improve the prospectus regime for non-equity securities

# Background



# New Regulatory Architecture



# FCA's Objectives for the New Regime

- Enable issuers to raise capital more quickly and at a scale that suits their needs
- Reduce regulatory costs
- Ensure that investors have the information they need
- Reduce regulatory barriers to investor participation where appropriate – i.e. SI requirement to 'have regard' to the desirability of facilitating offers being made to a wide range of investors
- Ensure appropriate oversight of offers coming to market via different routes

# Engagement Paper 1 - Admission to trading on a regulated market

- Draft SI will give powers to the FCA to set rules for what disclosures companies need to provide when seeking to admit securities to a regulated market
- Starting assumption is that most of the previous requirements for new admissions should be kept
- However, the FCA is considering small changes to the requirements around the exemptions, the form and content of a prospectus, responsibility for a prospectus, and the approval process
- Also considering changes to other related aspects, such as advertisements and COBS 11A



# Engagement Paper 2 - Further issuances of equity on regulated markets

- FCA is looking to take an ambitious approach in significantly scaling back the current prospectus requirements for further issuances by already-listed issuers
- The engagement paper sets out a list of non-exhaustive possible ways to reduce the current requirements, including:
  - Setting a threshold (i.e., size of the further issuance as a percentage of existing share capital) above which a prospectus would be required
  - Whether to allow issuers to only publish a simplified prospectus above this threshold or allow them to voluntarily publish a full prospectus
  - Requiring different offer type documents below the threshold (e.g., no requirement to publish an additional document, or requirement to publish an alternative form of document such as a cleansing notice)

## Engagement Paper 2 - Further issuances of equity on regulated markets (con't.)

- Key considerations will include exploring the recommendations from the UK Secondary Capital Raising Review (i.e. a 75% threshold) and other proposals or models (EU Listing Act, Australian models)

# Engagement Paper 3 - Protected forward-looking statements

- The Government aims to reduce the deterrent effect of current prospectus liability for categories of forward-looking statements:

Current regime	New regime
FLSs subject to a negligence liability standard. Defendant has burden of proving that they reasonably believed the information was accurate	<ul style="list-style-type: none"><li>• “Protected forward-looking statements” (PFLS) would be subject to a recklessness and dishonesty liability standard. Claimant has burden of proving that the defendant knew the statement to be untrue or was reckless as to whether it was untrue</li></ul>

- FCA empowered to make rules to define PFLSs that will benefit from the amended liability standard

# Engagement Paper 3 - Protected forward-looking statements (con't.)

- FCA is seeking views and suggestions on shaping this new regime, including:
  - What types of forward-looking statement should benefit from the amended liability standard / how should this category of statement be defined?
  - How should such information be presented within a prospectus?
  - Should the FCA set conditions on verification or explanations to accompany PFLS?

# Engagement Paper 4 - Non-equity securities

- FCA's initial view is that the current prospectus regime in the context of wholesale, DCM, does not need a major overhaul but is interested in views about whether there are areas for improvement:

Incremental improvements	Low denomination securities	Structured finance and investment products
<ul style="list-style-type: none"><li>• Certain changes to allow incorporation by reference of future financial information (i.e. at the point those items are published – rather than needing a supplemental prospectus)?</li><li>• Extending the validity of base prospectuses?</li><li>• Considering whether or not it is useful to continue to allow issuers to use URDs - given the very low usage in the UK</li></ul>	<ul style="list-style-type: none"><li>• Remove the existing dual standard of disclosure and instead to adopt a single standard for bond disclosure, with the existing wholesale disclosure annexes as a starting point?</li><li>• Could reduce disclosure requirements for corporate bond issuances by seasoned issuers with equity securities already admitted to regulated markets</li></ul>	<ul style="list-style-type: none"><li>• Considering additional disclosure for certain structured financial products or traded investment products</li><li>• Distinction between units of corporate, acquisition, project or public finance vs. products of the financial services industry</li></ul>

# Sustainability-related disclosures in prospectuses

- FCA exploring whether more specific ESG reporting requirements for prospectuses are needed:
  - Whether changes are desirable to ensure relevant sustainability information is included in admission prospectuses (Engagement Paper 1)
  - Better clarify expectations on the information required in the prospectus to better align it with ongoing reporting requirements in the annual report (e.g. TCFD, future ISSB standards)
  - How / what sustainability-related information could be included within the scope of protected forward-looking statements (Engagement Paper 3)
  - Whether additional requirements are needed for ESG-labelled debt instruments such as 'Use of Proceeds' bonds and sustainability-linked bonds (Engagement Paper 4)

# Next steps

- Feedback to the engagement papers should be sent by email to the FCA by 29 September 2023
- Further engagement papers on “primary MTF” regime and “public offer platforms” expected in June 2023
- Following the engagement process, the FCA intends to provide feedback on key points raised and publish consultation papers in 2024 to develop the specific rule proposals

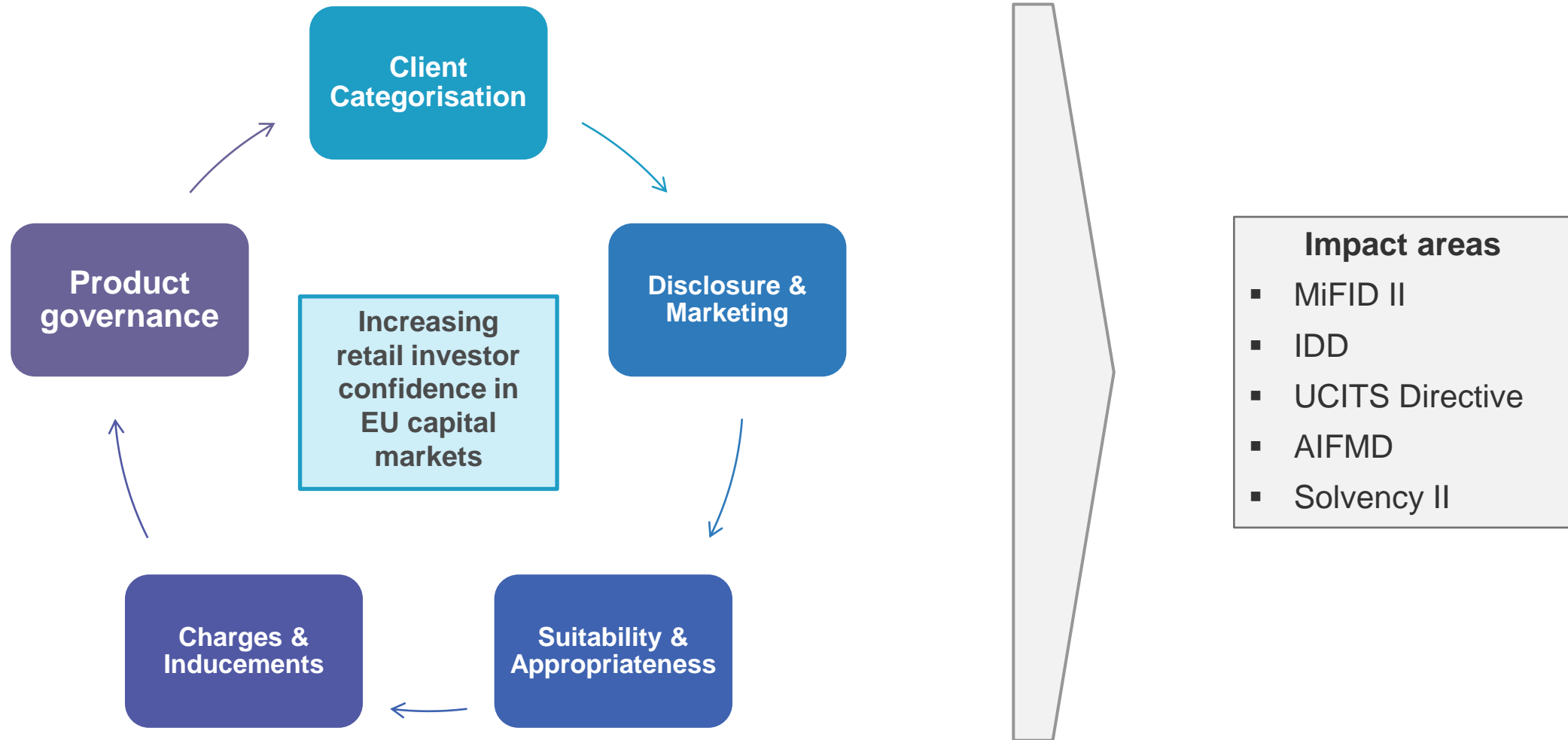


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The EU's Retail Investments Package, focusing on  
changes to MiFID II and PRIIPs  
Nicola Higgs and Jonathan Ritson-Candler



# EU Retail Investment Strategy (EU RIS)



# EU RIS: Supervisory objectives

- Cross-border supervision
  - Authorisation refusals and withdrawals
  - ESMA or host member state can request a home state regulator review
  - Online marketing
  - Reporting of cross-boarder services to home state regulator
    - more than 50 clients on a cross-border basis
    - ESMA register for NCAs
    - ESMA annual report

# EU RIS: Inducements

- Commission is concerned that the current MiFID II inducements rules do not adequately mitigate the risk of conflicts arising
- Initially considered outright ban of all 3rd party inducements
- Instead proposals tailor and tighten various aspects of the inducements regime. However, Commission will review after 3 years, so future change remains possible

# EU RIS: Inducements (con't.)

Service	Proposed changes to MiFID II inducements rules
<b>Execution only and RTO only services to retail clients</b>	<ul style="list-style-type: none"><li>• Ban on receipt / payment of inducements from / to a product manufacturer of the instruments to which the orders relate (as opposed to quality enhancement test under current, general inducements rules)</li><li>• <u>General exemptions from the ban:</u><ul style="list-style-type: none"><li>a) minor non-monetary benefits (MNMB) of a total value below €100 per annum (concern is that this is a low threshold compared to what firms may, to date, have gotten comfortable with as being MNMB under existing bans); or</li><li>b) inducements that could not be judged to impair compliance with the investment firm's duty to act in the <b>best interest of the client</b>, provided these benefits are clearly disclosed</li></ul></li><li>• <u>Specific exemptions from ban include:</u><ul style="list-style-type: none"><li>a) (other than PRIIPs) payment for underwriting and placing services provided to issuers where the same firm also provides execution services to end investors;</li><li>b) execution that is provided alongside a "main" service of non-independent advice; and</li><li>c) payment or benefit which is necessary for the provision of investment services (e.g., custody costs, settlement and exchange fees)</li></ul></li></ul>

# EU RIS: Inducements (con't.)

Service	Proposed changes to MiFID II inducements rules
<b>Portfolio management and independent investment advice</b>	<ul style="list-style-type: none"><li>• Existing ban on inducements <u>received by</u> PMs to remain in place – albeit a new indicative €100 p.a. threshold for MNMB to apply</li><li>• Ban made more strict as proposed to also include inducements <u>provided by</u> PMs (currently payment of inducements by PMs subject to the general inducements test rather than the ban)<ul style="list-style-type: none"><li>• this ban will also apply to PMs when servicing non-retail clients</li></ul></li><li>• No ban on inducements for non-independent advice (noting that the UK goldplated this in COBS 2.3A.15(1)(b) (same inducements ban applies in the case of restricted i.e., not independent advice to retail clients) as a result of pre-existing national rules)</li><li>• <u>However</u>, enhanced disclosures required explaining the difference between independent and non-independent advice</li></ul>
<b>Research unbundling</b>	<ul style="list-style-type: none"><li>• The exemption from the unbundling rules (such that research and execution fees can be rebundled for SME research subject to conditions) is being extended</li><li>• Commission proposes to raise market cap threshold over previous 36 months from €1bn to €10bn</li></ul>

# EU RIS: Inducements (con't.)

Service	Proposed changes to MiFID II inducements rules
<b>Client's best interests</b>	<ul style="list-style-type: none"><li>• Concept of “best interests of the client” replaces “quality enhancement test” for general inducements rule</li><li>• In addition, financial advisers must demonstrate they're acting in the best interests of clients by mandating that they:<ul style="list-style-type: none"><li>a) base their advice on an assessment of an appropriate range of financial products;</li><li>b) recommend the most cost-efficient financial product from the range of suitable financial products; and</li><li>c) offer at least one financial product without additional features which are not necessary to achieve the client's investment objectives such that retail investors can compare to alternative and possibly cheaper options</li></ul></li></ul>

# EU RIS: Client categorisation

- Opt up criteria for retail clients to be categorised as elective professionals are being relaxed

Type of investor	Proposed changes to MiFID II client categorisation rules
Natural persons	<ul style="list-style-type: none"><li>• Reduction of wealth criterion from €500k to €250k and be assessed as average over past 3 years</li><li>• More ways to demonstrate required K&amp;E:<ul style="list-style-type: none"><li>a) the third criterion has been expanded from “the client works or has worked in the financial sector” to also include “or undertaken capital market activities requiring to buy and sell financial instruments and/or to manage a portfolio of financial instruments which requires knowledge of the transactions or services envisaged”</li><li>b) new fourth criterion added as an alternative – the client can provide proof of recognised education or training which demonstrates their understanding of the relevant transactions or services envisaged and their ability to adequately evaluate the risks</li></ul></li></ul>

# EU RIS: Client categorisation (con't.)

Type of investor	Proposed changes to MiFID II client categorisation rules
Legal persons	<ul style="list-style-type: none"><li>• New criteria for legal entities which must meet at least two of the following:<ul style="list-style-type: none"><li>a) balance sheet total: €10m</li><li>b) net turnover: €20m</li><li>c) own funds: €1m</li></ul></li><li>• Plus the investment firm must assess that the legal representative of that legal entity or the person responsible for the investment transactions on behalf of that legal entity, understands the relevant transactions or services envisaged, is capable of making investment decisions in line with the legal entity's objectives, needs and financial capacity and is able to evaluate adequately the risks</li></ul>



# EU RIS: Marketing communications

- Proposal to introduce a financial promotions like marketing communications regime in the EU
- Turning on the following definitions:
- **“Marketing communications”**: similar definition to fin prom – not limited to retail clients. Also includes marketing by 3rd parties (non-investment firms) if they are remunerated or incentivised through non-monetary compensation by an investment firm
- **“Marketing practices”**: very broad – any strategy, tool or technique used by an investment firm or a 3rd party (as above) paid or incentivised by an investment firm to disseminate marketing comms, accelerate or improve their reach / effectiveness or promote, in any way, investment firms, financial instruments or financial services

# EU RIS: Marketing communications (con't.)

- Marketing communications and practices must be fair, clear and not misleading, appropriate for the target audience / market and disclose the essential characteristics and risks of the relevant financial instruments and/or investment services
- Firms required to prepare annual reports for the firm's management body on the use of marketing communications and practices
- Firms need to implement sufficient governance structure to review, approve and record keep

# EU RIS: Product Governance & Value for Money

- Retail investor products must offer “**value for money**”

Scope	Impact
<b>MiFID II &amp; IDD</b> Manufacturers & distributors of PRIIPs	New rules: <ul style="list-style-type: none"><li>• <b>Pricing policies:</b> Identify and quantify that all costs of manufacturing and distribution are *‘<i>justified and proportionate</i>’ having regard to the characteristics, objectives and, if relevant, strategy of the financial instrument and its performance</li><li>• <b>Regulatory reporting:</b> **Data on costs and performance of relevant products must be reported to NCAs. This will aid ***benchmarking amongst providers</li></ul>
<b>UCITS &amp; AIFMD</b> UCITS Man Cos and AIFMs	As above, plus enhancement of existing obligation: <ul style="list-style-type: none"><li>• <b>Pricing processes:</b> AIFMs and UCITS ManCos must identify, assess and review costs to prevent “<i>undue costs</i>” being charged to investment funds and their investors. “Due” costs will be specified and investors should be compensated for “undue costs”</li></ul>

\* Delegated Act to follow on meaning of ‘justified and proportionate’

\*\* RTS to follow on the data sets and standards / formats for reporting

\*\*\* Delegated Act to follow specifying how ESMA / EIOPA should develop relevant benchmarks

# EU RIS: Product Governance - PRIIPs

## Manufacturer product approval

1. For PRIIPs manufacturers: A clear identification and quantification of all costs and charges related to the financial instrument and an assessment of whether those costs and charges are **justified and proportionate**, having regard to the characteristics, objectives and, if relevant, strategy of the financial instrument, and its performance ('pricing process')
  - Comparison with the relevant ESMA published benchmark;
  - In the case of deviations from the relevant ESMA published benchmark – additional testing required to determine whether costs & charges are “justified & proportionate”
2. NCA reporting on 1. costs & charges (inc. distribution costs and third-party payments); 2. performance and risk profile of the product
3. Make available to distributors full details of the product approval process and complete and accurate details on any costs and charges

## Distributor product approval

1. For PRIIPs distributors:
  - Identify and quantify the costs of distribution and any further costs and charges not already taken into account by the manufacturer;
  - Assess whether the total costs and charges are **justified and proportionate**

The pricing process, shall include a comparison with the relevant benchmark, when available, on costs and performance
2. NCA reporting by distributor where products are manufactured by UK (i.e. third country) manufacturers

## Benchmarks

### Cost & Performance

*“ESMA shall, where appropriate, develop and make publicly available common benchmarks for financial instruments that present similar levels of performance, risk, strategy, objectives, or other characteristics, to help investment firms to perform the comparative assessment of the cost and performance of financial instruments, falling under the definition of packaged retail investment products, both at the manufacturing and distribution stages...”*

*The costs used for the development of benchmarks for investment firms manufacturing financial instruments shall, in addition to the total product cost, allow comparison to individual cost components. The costs used for the development of benchmarks for distributors shall, in addition to the total cost of the product, refer to the distribution cost.”*

# EU RIS: Costs and charges disclosures

- Costs and charges disclosures required for ECPs and professional clients, reversing the MiFID II quick fix amendments (albeit firms can again agree a “limited application” of the disclosure rules with those clients, as was the case pre-quick fix)
- Further standardisation of costs and charges disclosures including third party payments (e.g., explanation of their purpose and a quantification of their impact on expected returns) – further detail / templates to be set out in delegated acts

# EU RIS: Costs and charges disclosures (con't.)

- Annual statement of costs and charges must be provided to retail clients where investment services provided with and without safeguarding and administration of assets (unless the client is provided with online access to a system that is kept up to date and that it is proven they access)
- Additional risk warnings, including in marketing communications, for “particularly risky financial instruments” – TBC definition and further guidelines

# EU RIS: Suitability

Scope	Impact
<b>MiFID II &amp; IDD</b>	<p>New rules:</p> <ul style="list-style-type: none"><li>▪ <b>Suitability questionnaires</b><ul style="list-style-type: none"><li>▪ Source data from clients on their existing portfolios to consider need for portfolio diversification</li></ul></li><li>▪ <b>Suitability-lite</b><ul style="list-style-type: none"><li>▪ Advice on “well diversified, non-complex and cost-efficient products”. No need for these firms to collect data on K&amp;E or existing portfolio composition as part of the suitability assessment</li></ul></li><li>▪ <b>Risk warnings</b><ul style="list-style-type: none"><li>▪ *Standardised risk warnings</li></ul></li><li>▪ <b>Suitability reports</b><ul style="list-style-type: none"><li>▪ *Standardised suitability report template</li></ul></li><li>▪ <b>Advisor competence:</b> 1. 15 hours of professional development; 2. NCA specific requirements; and 3. includes reference to sustainability preferences</li></ul>

\* RTS to follow with standardised risk warnings and suitability report templates

# EU RIS: Appropriateness

Scope	Impact
MiFID II & IDD	<ul style="list-style-type: none"><li data-bbox="563 476 2372 615">▪ <b>Appropriateness test</b><ul style="list-style-type: none"><li data-bbox="657 525 2372 615">▪ Retail clients: Must collect information on capacity to bear full / partial loss and risk tolerance</li></ul></li><li data-bbox="563 629 2372 872">▪ <b>Appropriateness warnings</b><ul style="list-style-type: none"><li data-bbox="657 678 1243 721">▪ *Standardised risk warnings</li><li data-bbox="657 729 2372 872">▪ A client will have to expressly ask to proceed with an investment after receipt of a negative appropriateness assessment. A record must be maintained of 1. warning; 2. demand by client; 3. acceptance by the firm</li></ul></li><li data-bbox="563 886 2372 1222">▪ <b>No appropriateness assessment required</b><ul style="list-style-type: none"><li data-bbox="657 935 2372 1222">▪ *No requirement for an appropriateness assessment in the case of order execution or RTO services for: 1. non-complex products; 2. reverse solicitation; and 3. the client or potential client has been clearly informed that in the provision of that service the investment firm is not required to assess the appropriateness of the financial instrument or service provided or offered and that therefore he does not benefit from the corresponding protection of the relevant conduct of business rules</li></ul></li></ul>

\* RTS to follow with standardised risk warnings





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Global regulators and their reaction to the recent  
banking sector turbulence  
Rob Moulton

- Acceptance that there were supervision failures
  - FRB and FDIC
- Claims that 2018 “Economic Growth, Regulatory Relief, and Consumer Protection Act” deregulation went too far
  - Vice Chair Bass (FRIB) and Chair Gruenberg (FDIC)
- Acknowledgement that implementing Basel II “as soon as possible” is “important”
  - OCC

# US (cont.)

- Increase regulation of banks with between \$100bn and \$700bn of assets using existing powers
  - Focus on capital treatment of unrealised losses and exemption for banks below \$250bn
- New TLAC requirement
  - Prefer long term debt to deposits
- Full coverage of deposits was the reality
  - Consider formalising, or including payroll accounts
- Further legislative proposals aimed at Basel III likely Q3

# Europe

- No EU failures
- Seen as “a reminder of why we need a strong, functioning system [including] smaller and medium sized banks” (Commissioner Dombrovskis)
- New proposals for EU deposit guarantee schemes
  - Criticism from Germany
- Legislation to recognise preference for resolution over liquidation
- Extend deposit protection to: public entities; payment and e-money institutions; temporary high balances

- Political Edinburgh reforms largely deregulatory
- Regulatory approach in line
  - “The post-crisis reforms to bank regulation have worked. Today I do not believe we face a systemic banking crisis” (Andrew Bailey)
- Focus is on making existing system work and using post-Brexit freedoms to adjust aspects of the UK’s (often UK-only) regime

# UK (cont.)

- Ringfencing
  - Increase threshold to £35bn
  - Remove some banks from the regime
  - Remove restrictions on activities outside EEA
  - Impact of ringfencing on resolution
- Deposit protection
  - Consider raising £85,000 limit (as in practice, all deposits seem covered)
  - Increase speed of payout
  - Already expanded to cover payment and e-money (perhaps payroll accounts next?)

# London Financial Regulatory Portal

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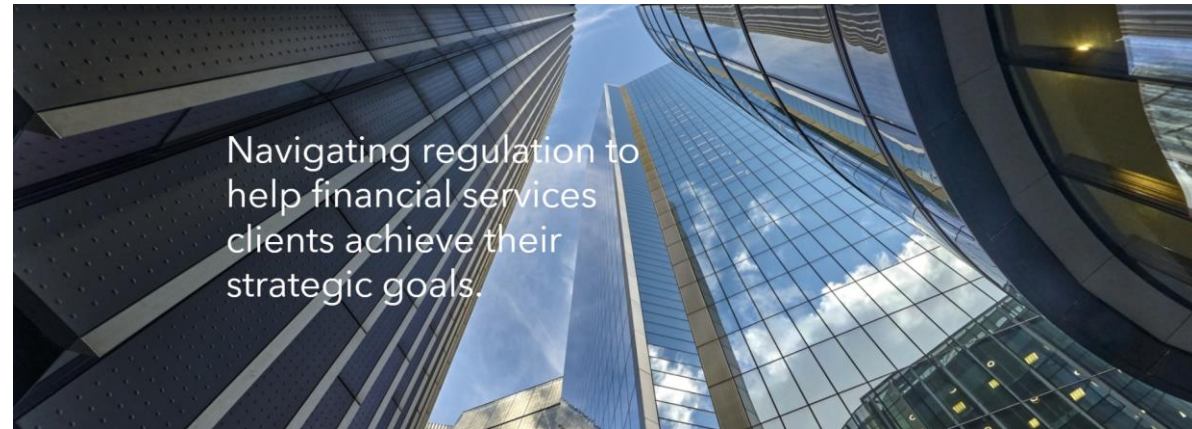
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