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15 March 2023

Financial Regulation Monthly Breakfast Seminar

Overview

- Future regulation of buy now pay later (BNPL) lenders
- Latest ESG updates, including the FCA’s Discussion Paper on ESG governance
- European Commission's call for evidence on the scope and third-country regime of the EU Benchmark Regulation
- FCA's wholesale data market study investigating the markets for benchmarks, credit ratings data and market data vendor services

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Future regulation of buy now pay later lenders

Becky Critchley

HMT consultation

- 14 February 2023 HMT consultation and draft legislation published and closes 1 April 2023
- Will be a further FCA consultation
- The government hopes to lay final legislation before Parliament later this year

Scope

- Change in scope to include only third party BNPL lenders
- Fixed-sum BNPL agreements will be regulated if the loan is:
  - Interest-free and repayable in 12 or fewer instalments within 12 months or less;
  - Provided by a person who is not the provider of goods or services which the credit agreement finances (i.e., third-party lenders, who will need to be authorised and regulated by the FCA); and
  - Not exempt as a result of falling within one of the new applicable exemptions (see further on this below)
- Merchants exempt from credit broking third party BNPL loans unless broking in borrower's homes
- Anti-avoidance mechanism

Exemptions

- Proposals include a number of exemptions:
  - Agreements financing premiums for insurance contracts;
  - Agreements offered by registered social landlords to tenants and leaseholders to finance the provision of goods and services, e.g., supporting the purchase of white goods; and
  - Loans made by employers to employees (either directly or via a specialist company offering employee benefits) repaid by monthly salary deductions, e.g., for the financing of season tickets or tenancy deposits

Approach and transition to new regime

- Some helpful confirmations and clarity in the approach to regulatory controls for BNPL lending:
  - Approval of merchant financial promotions
  - Disapplying the pre-contractual disclosure requirements under the Consumer Credit Act 1974 (CCA) with FCA rules covering this area to allow for more flexibility and proportionality applying instead
  - Excluding newly regulated BNPL agreements from the existing small agreements provisions in the CCA, such that BNPL agreements of any value, including those not exceeding £50, will be subject to the full suite of CCA requirements

Approach and transition to new regime

- Some helpful confirmations and clarity in the approach to regulatory controls for BNPL lending:
  - Tailoring the current FCA rules on affordability
  - Applying the current form and content requirements for agreements
  - Retaining current trigger points for post-contractual information regarding arrears or default
  - Retaining Section 75 CCA
  - Access to the FOS
- Temporary permissions regime

Latest ESG updates, including the FCA's Discussion Paper on ESG governance

Anne Mainwaring

Background

- On 10 February 2023, the FCA published DP23/1: Finance for positive sustainable change: governance, incentives and competence in regulated firms
- The FCA considers that a firm’s governance, purpose, and culture are central to how it embeds environmental and social considerations into business, risk, and capital allocation decisions for the benefit of consumers.
- With this in mind, the FCA is seeking views on how it can move effectively beyond disclosure-based initiatives to help and encourage firms as they develop their arrangements for governance, incentives, and competence in the area of sustainability

Background

- Aim of DP is to encourage industry-wide dialogue on firms' sustainability-related governance, incentives and competencies. In a field where there are many initiatives taking place, FCA aims to help narrow this field and help with highlighting good, evolving practices if finance is to deliver on its potential to drive positive, sustainable change
- FCA is committed to developing *"a policy approach to ESG governance, remuneration, incentives and training/certification in regulated firms"*
- FCA seeking feedback on what the industry would find most helpful in this area
- FCA will consider proportionality and whether it should differentiate between firms when deciding course of action
- Deadline for feedback: 10 May 2023

FCA's supervisory engagement

- FCA in parallel commencing with supervisory engagement and encourages firms to introduce measures now
- FCA expects firms to *"be accountable for their sustainability-related claims and commitments – linking their governance arrangements and incentive structures to their stated objectives, and building relevant skills and capabilities across their organisations"*
- FCA encourages firms to reflect on the matters discussed in the DP and consider incorporating them as appropriate

Areas of focus

Area of focus	Feedback sought
Objectives, purpose, business and strategy	• Should all financial services firms be expected to embed sustainability related considerations in their business objectives and strategies? If so, what should be the scope of such expectations? Please explain your views
Culture as an enabler	• Beyond the FCA's ongoing work on diversity and inclusion, and introduction of the Consumer Duty, should we consider setting regulatory expectations or guidance on how firms' culture and behaviours can support positive sustainable change? Please explain your views
Governance, responsibility and accountability	• What steps can firms take to ensure that they have the right skills and knowledge relating to material climate and sustainability related risks, opportunities and impacts on their boards? Should we consider setting any regulatory expectations or guidance in this area? If so, what should be the scope of such expectations? • What are likely to be the most effective strategies in embedding climate and sustainability related considerations across a firm's operations? What is the potential benefit of initiatives such as the appointment of functional 'champions', or the creation of dedicated working groups or forums? And how can the value of such initiatives be enhanced? • What management information does senior management use to monitor and oversee climate and sustainability related developments, and to monitor progress against public commitments? Should we set expectations or guidance for decision making processes, including systems and controls, audit trails and the flow of management information to key decision makers?

Areas of focus

Area of focus	Feedback sought
Accountability	• Should we consider setting new regulatory expectations or guidance on senior management responsibilities for a firm's sustainability-related strategy, including the delivery of the firm's climate transition plan? If so, which existing SMF(s) would be the most suitable to assume these responsibilities? Please explain your views
Governance of products and services	• Should we consider introducing specific regulatory expectations and/or guidance on the governance and oversight of products with sustainability characteristics, or that make sustainability claims – for example to clarify the roles and expectations of governing bodies such as Fund Boards? If so, which matters in particular would benefit from clarification?
Integration, remuneration and incentives	• What matters should firms take into consideration when designing remuneration and incentive plans linked to their sustainability related objectives? In particular, we welcome views on the following: (a) the case for linking pay to sustainability related objectives (b) whether firms should break down their sustainability related commitments into different factors, allocating specific weightings to each (c) whether short term or long term measures are more appropriate, or a combination of both (d) whether sustainability related incentives should be considered for senior management only, or a wider cohort of employees (e) how firms could consider remuneration and incentive plans in the design and delivery of their transition plans (f) remuneration adjustments where sustainability related targets (at either the firm level or individual level) have not been met. Please explain your views. • Should we consider additional regulatory expectations or guidance in any of the areas considered above? Please explain your views

Areas of focus

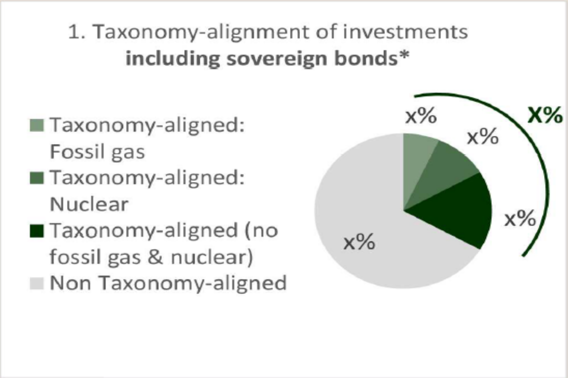
Area of focus	Feedback sought
Governance of investor stewardship to influence positive change	• Should we consider additional regulatory measures to encourage effective stewardship, particularly in relation to firms’ governance and resourcing of stewardship, and associated incentive mechanisms and conflict of interest policies? Are there regulatory barriers that we should consider? Please explain your views • What additional measures would encourage firms to identify and respond to market wide and systemic risks to promote a well functioning financial system? How can the collective stewardship efforts of asset owners and asset managers best be directed towards the most pressing systemic issues? And how can remaining barriers best be reduced? Please explain your views
Training and competence on sustainability in regulated firms	• What do you consider to be the main sustainability-related knowledge gaps across the financial sector and how can these best be addressed? What do you consider to be the potential harms to market integrity, consumer protection or competition arising from these knowledge gaps? • Do you think there is a need for additional training and competence expectations within our existing rules or guidance? If so, in which specific areas do you consider further rules and/or guidance are required? Please explain your views • Which aspects of the training and capability building initiatives discussed above, or any others, would be particularly useful to consider (for example in identifying which skills and/or training is needed) and how best should we engage with them? • Have you seen misrepresentation of ESG credentials among ESG professionals and, if so, what are the potential harms? Have you seen any consistent training metrics that can help compare firms’ knowledge/ capabilities? Please describe

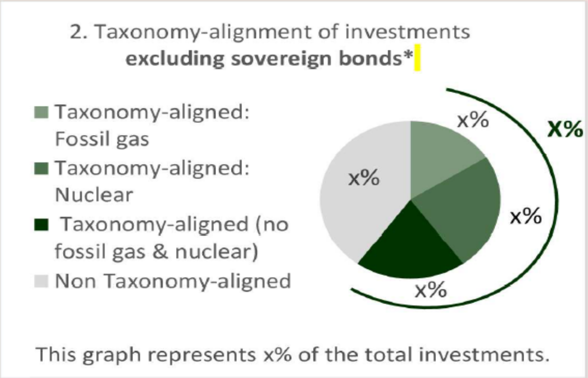
Taxonomy's amendments to the SFDR regulatory technical standards on the disclosure of investment in nuclear and gas-related activities

- Does the financial product invest in fossil gas and/or nuclear energy related activities that comply with the EU Taxonomy?
    - ❑ *Yes*
        - ❑ *In fossil gas*
        - ❑ *In nuclear energy*
    - ❑ *No*

The two graphs below show in green the minimum percentage of investments that are aligned with the EU Taxonomy. As there is no appropriate methodology to determine the Taxonomy-alignment of sovereign bonds*, the first graph shows the Taxonomy alignment in relation to all the investments of the financial product including sovereign bonds, while the second graph shows the Taxonomy alignment only in relation to the investments of the financial product other than sovereign bonds.

[only include in the graphs the figures for Taxonomy aligned fossil gas and/or nuclear energy as well as the corresponding legend and the explanatory text in the left hand margin if the financial product makes investments in fossil gas and/or nuclear energy Taxonomy-aligned economic activities]





* *For the purpose of these graphs, 'sovereign bonds' consist of all sovereign exposures.*

FCA regulatory initiatives grid

- FCA has published its latest regulatory initiatives grid setting out the planned regulatory initiatives for the next 24 months
- Highlights focus on ESG and provides a useful tracker of ESG initiatives in the UK

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European Commission's call for evidence on the scope and third-country regime of the EU Benchmark Regulation

Becky Critchley

European Commission's call for evidence on BMR third country regime

- Commission’s call for evidence published 1 March 2023, closes 29 March 2023
- Part of the broader BMR review which is to check whether the scope of the EU rules for financial benchmarks as well as the rules for the use of non-EU financial benchmarks are still fit for purpose. The review deadline is 15 June 2023
- The call for evidence is intended to obtain more detailed information on specific issues of access to third country benchmarks and states that it aims to ensure the most economically relevant third country benchmarks for the EU market are subject to EU supervisory scrutiny

European Commission's call for evidence on BMR third country regime

- BMR regime for third country benchmarks:
    - Extension of the BMR third country transitional regime to end 2025 still likely (and possibly beyond)
    - Need to ensure that the most economically relevant third country benchmarks for the EU market are subject to EU supervisory scrutiny
    - New ‘designation-based’ third-country regime
    - Perhaps not as extensive a rolling back as previously stated
    - Anti-avoidance
- UK / EU divergence

European Commission's call for evidence on BMR third country regime

- ESG benchmarks:
  - Regulation of non-EU Climate Transition Benchmarks and Paris-Aligned Benchmarks
  - EU ESG Benchmark label

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FCA's wholesale data market study investigating the markets for benchmarks, credit ratings data and market data vendor services

David Little

What is an Enterprise Act Market Study?

Commencement
Market study notice published

Possible intervention
Stakeholders can comment on commencement notice

1 Sep 2023
Notice of proposed decision on possible market investigation reference

Possible intervention
Stakeholders can comment on interim report

1 Mar 2024
Market study report published

- Reference made to CMA for **market investigation**

OR

- Non-legally binding **recommendations**

OR

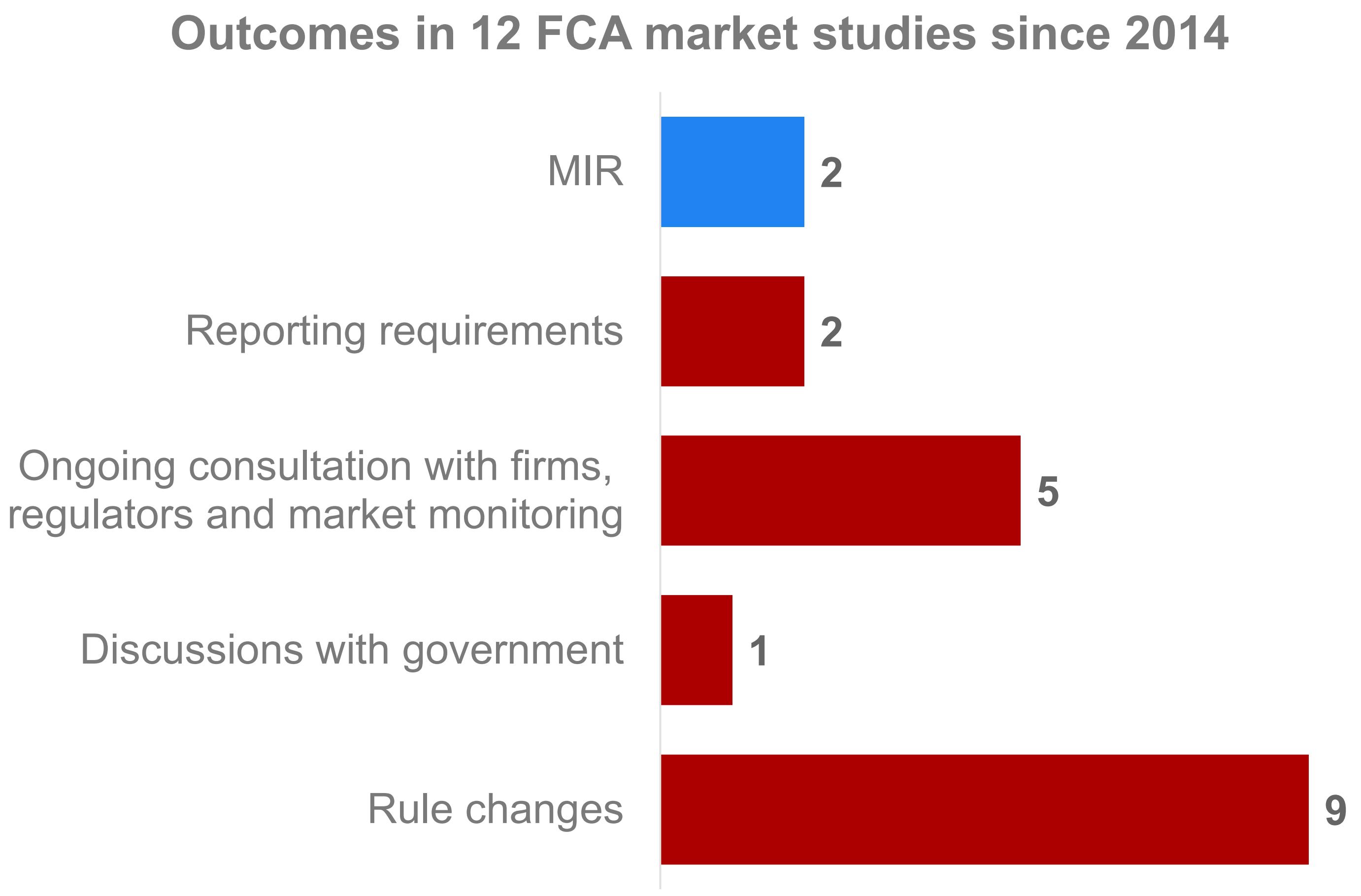
- Other outcomes

Throughout, possibility of stakeholders **being required** to submit information/documents.

What can the FCA do?

- At the end of the twelve months, the FCA has the following options:
  - No further action / defer to Future Regulatory Framework Review
  - Making (non-binding) recommendations to government or another authority
  - Publishing guidance
  - Proposing greater industry self-regulation
  - Making rules, or removing rules
  - Introducing firm-specific remedies or taking enforcement action against individual companies (under FSMA or Competition Act 1998)
  - Referring one or more features of the market to the CMA for further investigation (**MIR**) or accepting “Undertakings in Lieu” of making an MIR

What has happened in the past?



* A market study can result in more than one outcome.

- FCA's previous market studies all under FSMA. **11 market studies since 2014**, plus one joint study led by the CMA
- FCA always had power to refer market to CMA under FSMA: done only once (twice when including CMA-led joint study)
- Only two MIR from a sector regulator since 2014: Ofgem in 2014, and FCA in 2017
- Asset Management Market Study referred by FCA to CMA, despite UILs, and resulted in binding industry reforms

What is likely here?

- Like other sector regulators, **FCA under pressure to use its competition powers**. Launching this study – the first one under the Enterprise Act – may be enough
- FCA has already pointed to Consolidated Tape and Future Regulatory Framework Review: **potential to defer actions to these initiatives**
- Market study can become **lightning rod** for customers (whether or not they are regulated by the FCA) to voice and evidence concerns, and for suppliers to respond on the record
- **Systematic evidence gathering**: potential fuel for future Competition Act investigations by FCA or CMA, independent of market study outcome

What is likely here?

- Scope for UILs by major index providers, CRAs or data vendors to alleviate any initial concerns: **voluntary codes of conduct**, *etc.* Customers can influence these proposals and whether FCA accepts them
- FCA recognises limitations in a global market, but London can set trends others will follow: **dovetails Brexit politics**. FCA and CMA have experience in introducing reforms in industry through a market study

Update – FCA's observations on ICARA process and IFPR

- The FCA carried out a multi-firm review
- Groups
  - Most firms completed a group ICARA process, but without sufficient consideration of firm-specific risks and with only a few operating solo ICARA processes (required by MiFIDPRU)
- Wind down planning assessments
  - Often completed
  - Too often weak in scope and quantification, with the FCA referencing their prior guidance

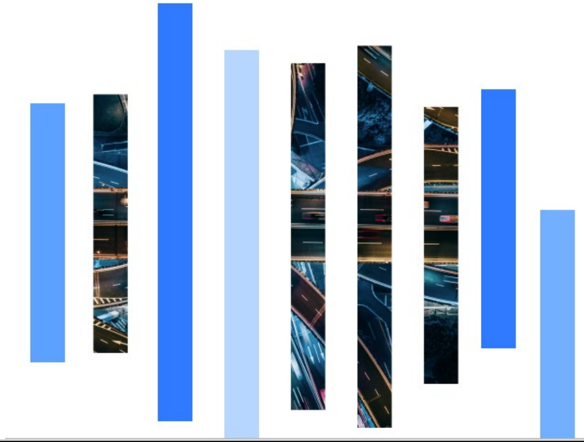
Update – PRA proposals on remunerations for small CRR firms

- Paper titled “Enhancing Proportionality for Small Firms”
- Aligned definition of small firm with the simpler-regime criteria under the Strong and Simple Framework
  - (Typically average assets under £4 billion)
- Very limited simplification: removing the following rules
  - Malice and clawback
  - Buyouts
- A sign of things to come under the Edinburgh framework?

Whistleblow Insights: Recurrent Themes and Common Drivers

With a marked recent increase in the number of whistleblows across the financial services sector, this guide highlights recurrent themes and common drivers, and poses gently provocative self-assessment questions against which firms can usefully benchmark themselves.

Please click here to read the full publication.



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HM Treasury Publishes Draft Legislation to Regulate BNPL Lending

DP 23/1: FCA Publishes Discussion Paper on Sustainability-Related Governance, Incentives, and Competence

European Parliament Publishes Proposed Changes to AIFMD and UCITS Directives

ESG and Sustainable Finance