

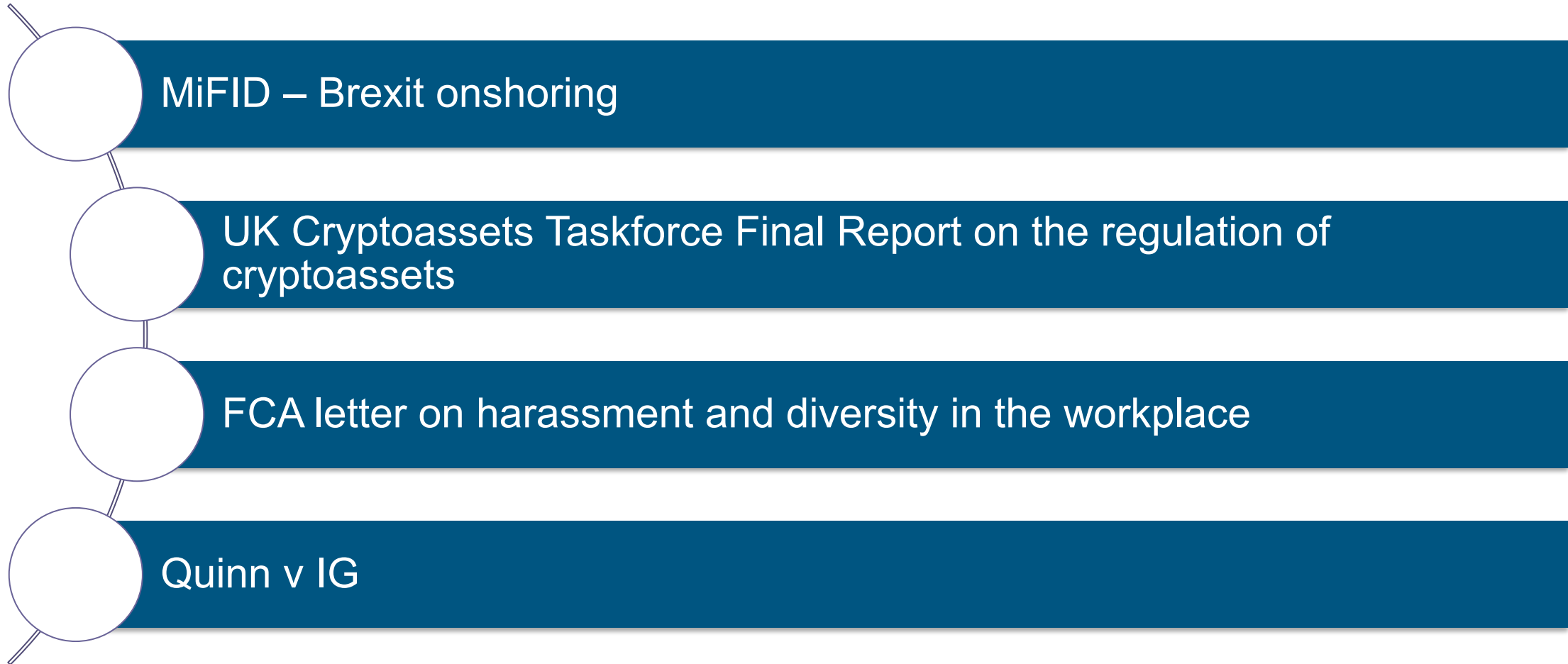
A blue-toned background image featuring a financial line chart with multiple data series and a grid. The chart shows various trends, including a sharp decline followed by a recovery and another decline.

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7 November 2018

Financial Regulation Monthly Breakfast Seminar

Overview



A blue-toned background image 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-oriented.

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The key impacts on the MiFID regime of the recent
Brexit onshoring documents
Anne Mainwaring and Carl Fernandes

The onshoring process

- EU (Withdrawal) Act (the “EUWA”)
 - Preserves existing UK laws which implement EU obligations
 - Converts existing EU law at the point of exit into UK law
 - Note however that level 3 guidelines and recommendations are not being onshored but will remain relevant
 - The EUWA only onshores operative provisions and so will not incorporate recitals into UK legislation
- The onshoring process assumes a ‘hard’ Brexit
 - No deal in place and no transitional period
- The EUWA includes powers to amend legislation to correct deficiencies which arise as a result of the UK’s exit from the EU
 - There is no scope beyond this to make wider policy changes as part of the onshoring process

Key impacts of the onshoring exercise on the MiFID II regime

- Draft MiFID Brexit statutory instrument
 - Will amend UK primary and secondary legislation that implements the MiFID II Directive and Level 2 Delegated Directive
 - Will amend the retained versions of MiFIR and the Level 2 Delegated Regulations
- FCA Consultation Papers
 - CP18/28 Brexit: proposed changes to the Handbook and Binding Technical Standards – first consultation (October 2018)
 - Note also CP18/29: temporary permissions regime for inbound firms and funds (October 2018)

Key impacts of the onshoring exercise on the MiFID II regime

Transparency

- The MiFID II transparency regime will be subject to some of the most significant changes as a result of the onshoring process both in the short and long term
- In order to address a number of 'inoperables' in the onshored transparency regime the FCA will be given a number of temporary powers during a transitional period of up to four years in order to ensure that the transparency regime operates effectively during this time
- The draft SI also makes certain changes to the long term functioning of the transparency regime

Key impacts of the onshoring exercise on the MiFID II regime

Double volume cap

- During a transitional period the FCA will have the power to introduce new DVC suspensions for up to six months, which will be renewable where the FCA considers that the conditions which led it to impose a suspension continue to exist
- The FCA will have the ability to take into account trading volumes in any third country (not just within the UK / EU)
 - Enables the FCA to respond to new EU DVC suspensions
 - Enables the FCA to introduce new suspensions as it considers appropriate
- In the long term the FCA will be given powers to direct the geographical scope of the trading data on which the DVC calculations are based
 - Provides the FCA with flexibility to determine the appropriate application of the DVC (UK, EU, or wider)

Key impacts of the onshoring exercise on the MiFID II regime

Pre and post trade transparency

- During the transitional period the FCA will have the power to suspend the transparency requirements by reference to a wider set of information than is currently the case under MiFIR
 - In particular the FCA will be able to take into account any relevant information in relation to the liquidity in the relevant financial instrument whether in the UK or any other country
 - Gives the FCA the ability to respond to EU suspensions as well as introduce any new suspensions that it considers appropriate
- In the long term the FCA will be able to direct the geographical scope for calculating the relevant thresholds subject to certain conditions

Key impacts of the onshoring exercise on the MiFID II regime

Systematic internalisers

- The FCA will have the power during the transitional period to publish the data required for UK firms to perform the SI threshold calculations
- Long term the FCA will be given powers to direct the geographical scope of the data used for the SI calculations in the UK
 - Will enable the FCA to ensure that the SI thresholds are appropriate for the UK whilst also considering alignment with other relevant markets

Key impacts of the onshoring exercise on the MiFID II regime

Transaction reporting

- Current scope of reporting (EEA + UK) will be retained
- UK firms will therefore need to continue to submit transaction reports to the FCA in relation to trades in financial instruments admitted to trading, or traded, on trading venues in the UK and in the EEA
- UK branches of EEA firms currently send transaction reports to their home state regulator
- As the onshoring process assumes that all information sharing will cease, UK branches of EEA firms will need to transaction report to the FCA in the same way as UK branches of non-EEA firms

Key impacts of the onshoring exercise on the MiFID II regime

Transaction reporting (continued)

- UK trading venues will have to report transactions on their venue by EEA firms – they will not however need to report for UK branches of EEA firms as they will be required to submit their own transaction reports
- The FCA will become responsible for maintaining a UK FIRDS database

Key impacts of the onshoring exercise on the MiFID II regime

Trading obligation

- The share and derivatives trading obligations will be onshored with a UK scope
- In order to comply with these obligations firms trading shares and derivatives subject to the UK trading obligation will need to do so on:
 - A UK regulated market
 - A UK MTF
 - A systematic internaliser meeting the UK specific definition set out in the MiFID Brexit SI
 - A third country trading venue assessed as equivalent by the EC pre-exit or by HMT post-exit

Key impacts of the onshoring exercise on the MiFID II regime

Temporary permissions

- The MiFID Brexit SI introduces specific provisions in relation to the application of MiFID for EEA firms that intend to take advantage of the UK's temporary permissions regime
- In particular the SI introduces the concept of substituted compliance
 - Where a firm within the regime complies with a requirement in MiFIR (as it applies in the EEA) provided that requirement has equivalent effect to the corresponding requirement in the UK onshored version of MiFIR the firm is to be treated as complying with the UK requirement
 - Note however that substituted compliance is disapplied in relation to various requirements



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The recent publication of the UK Cryptoassets Taskforce
Final Report on the regulation of cryptoassets by the
Treasury, Bank of England and FCA

Stuart Davis

Overview: the Taskforce

- Joint report by Bank of England, FCA and the Treasury
- Taskforce established and consultation announced by Chancellor in March 2018
- Key aspects of the Final Report include:
 - AML/KYC
 - Regulatory classification of crypto-assets
 - A potential ban on retail cryptocurrency derivatives
 - Indication of other areas for UK regulatory intervention
 - Discussion of use of distributed ledger technology in financial services
- Taskforce will also be involved in international efforts on regulation of the sector

AML / KYC

- The use of crypto-assets for illicit activity remains low
- However, anonymity of crypto-assets may make them attractive to criminals
- Treasury will consult on gold-plating MLD5 to extend AML/CTF obligations to:
 - Exchange services between different crypto-assets, to prevent anonymous “layering” of funds to mask their origin
 - Platforms that facilitate peer-to-peer exchange of crypto-assets, which could enable anonymous transfers of funds between individuals
 - Crypto-asset ATMs, which could be used anonymously to purchase crypto-assets
 - Non-custodian wallet providers that function similarly to custodian wallet providers, which may otherwise facilitate the anonymous storage and transfer of crypto-assets

AML / KYC

- Also consideration as to whether to extend the regime to non-UK firms providing services to UK customers
- Consultation will begin in early 2019

Regulatory classification of crypto-assets

3 broad types of crypto-assets:

- “Exchange tokens” — crypto-assets that are not backed by a central bank or other central body, and do not provide the types of rights or access provided by security or utility tokens (often referred to as cryptocurrencies, e.g., Bitcoin, Litecoin)
- “Security tokens” — crypto-assets that fall within the definition of an existing regulated investment in the UK, typically providing rights such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits
- “Utility tokens” — crypto-assets that can be redeemed for access to a specific product or service that is typically provided using a DLT platform

Regulatory classification of crypto-assets (continued...)

- Utility tokens and exchange tokens generally do not fall within the regulatory perimeter, whereas securities tokens do
- By end of 2018 FCA will consult on additional perimeter guidance specific to crypto assets
- Treasury will consult in early 2019 to understand whether there are crypto-assets on the UK market which have comparable features to securities but which fall outside regulation – Treasury will seek to close the gaps
- Contrast position with recent Treasury Select Committee report which sought to regulate all crypto-assets

Potential ban on retail cryptocurrency derivatives

- By the end of 2018, the FCA will consult on a ban on the sale of all kinds of derivatives which reference cryptocurrencies to retail customers
- FCA proposals would go beyond ESMA's temporary product intervention measures for CfDs because:
 - FCA's measures would be permanent; and
 - FCA's ban would apply to all crypto-derivatives, not just CfDs
- FCA also states that it is unlikely to approve the listing of securities or funds that reference cryptocurrencies

Indication of other areas for potential UK regulatory intervention

Report notes a number of areas of concern:

- “Market abuse-style activities”
- Poor governance, systems and controls and conflicts management
- Lack of reliability, availability and accessibility of market infrastructure

DLT in financial services

- Reaffirmation of “technology neutral” approach to regulation
- No changes in regulation required for firms to adopt DLT
- Commitment of support for FinTech in financial services
- However, legal and regulatory considerations for utilisation of DLT include:
 - Competition issues
 - Legal challenges, including civil law and data protection
 - Settlement finality for payment and securities settlement systems
 - Governance challenges resulting from lack of central point of authority

Next Steps and Timing

Consultation	Authority	Expected Timing
Consultation on additional perimeter guidance specific to crypto-assets	FCA	By end of 2018
Consultation on potential ban on the sale of derivatives referencing cryptocurrencies like Bitcoin to retail customers	FCA	By end of 2018
Consultation in order to understand whether there are crypto-assets on the UK market that have comparable features to existing regulated investments but are structured in a way that means they avoid regulation	Treasury	Early 2019
Consultation on whether and how cryptocurrencies and firms providing services in relation to cryptocurrencies (such as cryptocurrency exchanges and wallet providers) could be regulated effectively, if necessary	Treasury	Early 2019
Consultation on proposed gold-plating of the implementation of the EU Fifth Anti-Money Laundering Directive in the UK to provide a robust regulatory response to the use of crypto-assets for illicit activity	Treasury	Consultation in early 2019, with implementing legislation during 2019



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Latest thinking from the FCA on harassment and diversity in the workplace

Andrea Monks

FCA's Letter to the Women and Equalities Commission

“The benefits of diversity of thought cannot be achieved without a culture that is actually diverse and inclusive” – Megan Butler, Executive Director Supervision

- Culture

- FCA is drawing a clear bright line between good culture and diversity
- Lack of diversity is an obstacle to retaining the best talent, making the best business choices, taking the best risk decisions
- FCA considers levels of diversity and inclusion shape a firm's culture
- Tolerance of sexual harassment is a clear example of poor culture
- A culture where sexual harassment is tolerated is not one which would encourage people to speak up and be heard, or to challenge decisions

FCA's Letter to the Women and Equalities Commission

- SMCR
 - “Fit and proper” includes “non-financial” conduct
 - FCA will consider sanctions for discrimination, harassment or sexual misconduct
- Transparency and whistleblowing
 - Firms must notify the FCA of potentially serious misconduct
 - Firms must demonstrate they have the right processes in place to handle harassment cases
 - FCA is “especially interested” in firms systemically mishandling allegations or incubating a culture of sexual harassment
 - Individuals can raise sexual harassment issues with FCA directly through the whistleblowing procedures
 - “Gagging orders” do not prevent someone blowing the whistle to the FCA

FCA's Letter to the Women and Equalities Commission

- Risk and success
 - *“Diversity is fundamental to business success and to the reduction of failure”* – Megan Butler, March 2018
 - Diversity helps to stop groups from converging around poor decisions
 - Women as investors outperform men by 1.1%, with lower risk and volatility
 - Mixed-gender investment fund teams attract 6% more inflows than teams run solely by men
 - A strong female presence at board level translates into significantly higher RoE for firms
 - Firms that promote gender diversity significantly lower their conduct risk - firms with monocultures suffer 24% more governance-related issues than their peers

FCA's Letter to the Women and Equalities Commission

- And for anyone who thinks their firm isn't at risk.....

“One of our female [FCA] supervisors was recently referred to as “little lady” by a senior leader from one of the UK’s biggest banks”

FCA & PRA letters on Remuneration

“Cultures that promote diversity and inclusion will have wider benefits for an organisation; they are more likely to encourage speaking up, better decision making and good conduct outcomes...”

- FCA (1 Nov 18 (dated 20 Aug 18)) & PRA (18 Oct 18) published **Dear SMF 12 (Rem Co Chair) letters**
- Sent to Tier 1 firms (UK banks, building societies and investment firms with relevant total assets exceeding £50 billion)
- Relates to the 2018/19 remuneration round

FCA & PRA letters on Remuneration

- FCA will assess how a firm's remuneration policy reinforces a firm's values, ethics and culture, and promotes the right behaviour:
 - How any issues fed back as part of the previous remuneration round have been addressed
 - Results of gender pay gap analysis and plans for addressing inequalities and any drivers of poor culture
- Ex-post risk adjustment (SYSC 19D) justifications: firms are adjusting awards, but the size of an adjustment may not always match the seriousness of an incident or misconduct
- FCA & PRA will no longer provide a "non-objection" to a firm communicating and distributing variable remuneration awards:
 - Expect greater emphasis on role of SMF 12 (Rem Co Chair)
 - PRA / FCA will write to a firm following the remuneration round, highlighting positive areas of engagement and any issues to be addressed



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The recent high court case looking at the FCA's
appropriateness and client's best interests rules
(Quinn v IG)
Rob Moulton

Peter Quinn v IG Index Limited

- High rolling spread better
- Passed appropriateness test
 - Offered upgraded “Select Account” which gave margin flexibility (experience score suggested a standard account)
- Suffered heavy losses
- Periodically closed then reopened accounts
 - Sometimes after contact / hospitality from IG
- Claimed IG breached appropriateness rule (COBS 10.2.1R) and client’s best interests rule (COBS 2.1.1R)

Appropriateness rule

- IG breached COBS 10.2.1R by upgrading the account
 - But that did not give rise to the loss, which would have been suffered anyway
- Commentary around whether defendant read the risk warning and accompanying documents (having ticked the box)
 - Judge could have said it didn't matter
 - Instead said “it is inconceivable in my judgment that someone who has been as successful as the claimant in his business life could have been so by failing to read the terms on which his commercial counter parties were prepared to do business”

Client's best interest rule

- “A firm must act honestly, fairly and professionally in accordance with the best interests of its clients”
- Judge found this added nothing to the substantive rules
 - “It is mistaken to suppose that COBS 2.2.1R imposed on the defendant any [] duty to advise beyond that provided for in COBS 10”
 - “To construe the provision [otherwise] would be to construe it as imposing a duty massively in excess of that which has been recognised at common law and [by] the appropriate degree of [consumer] protection”
- If wrong, Judge says defendant would have spread bet elsewhere anyway



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Questions?