EFFECTA
REGULATORY CONSULTING

EFFECTA REGULATORY NEWSLETTER NO 2. 2021

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Welcome to the Effecta Compliance regulatory newsletter. In the ever changing regulatory landscape, it is key that firms keep up to date to with latest compliance developments and ensure relevant compliance changes are considered internally and implemented by firms and ahead of any deadlines set by the Regulator. Our newsletter is designed to provide information on the latest regulatory topics in an easy to read and succinct format. In this newsletter we cover the following topics:

- FCA IFPR Consultation Paper 21/7
- Financial Conduct Authority Temporary Permission Regime
- UK Climate Disclosures
- FCA Review of host Authorised Managers (AFMs)
- FCA Business Plan 2021/22
- Changes to UK MIFID's conduct and organisational requirements (CP21/9)
- UK Government Taskforce on Innovation, Growth and Regulatory Reform
- HM Treasury's Wholesale Markets Review: Consultation

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FCA IFPR Consultation Paper 21/7

The FCA closed its second consultation paper (CP21/7) on the Investment Firm Prudential Regime (IFPR) on 28th May 2021.

The consultation paper provided some more of the detail needed to prepare for the IFPR, which will apply from 1st January 2022. The consultation also finalises the capital and liquidity requirements and the new Internal Capital And Risk Assessment ("ICARA") process, which will alter the way firms need to review and manage their risk. **You can find the FCA CP21/7** here.

A third consultation paper CP21/26 has been published and opened as of 6th August 2021. The consultation period for this paper will close on 17th September 2021. This consultation paper focuses mainly on disclosure requirements around remuneration, risk management, own funds, and own funds requirements. The final rules are due in Autumn 2021. **You can find this paper linked** here.

Financial Conduct Authority Temporary Permission Regime

The UK and EU are still currently in the process of negotiating access for London based financial services firms into the EU market. These equivalence negotiations will be hugely important, not only to allow UK companies to continue to provide financial services to EU clients post passporting, but also to determine the direction the regulators want to take post-Brexit.

After the Temporary Permission Regime for firms expired at the end of 2020, many firms have had to limit or change how their business works, reducing the services that can be provided to EU clients and in some cases moving their offices to mainland Europe.

The UK-EU Trade and Cooperation Agreement (TCA) was signed on 30th December 2020 but contains very few provisions on financial services. However, the two sides also signed a memorandum of understanding (MoU) on regulatory co-operation in March 2021. This MoU will allow the UK and the EU to cooperate with regards to financial services and financial services regulation.

Despite these positive developments, there are some signs that the UK and EU regulatory frameworks are likely to diverge over time. The FCA will also be considering its regulatory approach and seeking to tailor it for UK markets; Chancellor Rishi Sunak made this clear in plans outlined in November last year.

You can find the Chancellors plans outlined here.

UK Climate Disclosures

Between 24th March and 5th May, the UK Government consulted on its proposals for mandatory disclosure of climate-related financial information for companies with more than 500 employees and more than £500m turnover. This consultation related to draft regulations which are due to be published this year. These draft regulations will also introduce reporting obligations which are due to be phased-in in stages from April 2022, with all relevant Firms required to report by 2025.

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A number of companies already choose to voluntarily report under the framework set out by the Task Force on Climate-related Financial Disclosures (TCFD). These centre upon disclosure around four areas (Governance, Strategy, Risk Management and Metrics & Targets) but the disclosure levels are low with many companies choosing not to report under every area. Therefore, the UK Government is looking to combat this by making the disclosures mandatory. The expanded requirements would require the following information to be disclosed:

- Governance – A description of the organisation's governance arrangements to identify and manage risks and opportunities arising from climate change
- Strategy – A description of how strategy may change in response to climate change
- Risk Management – A description of risks involved, and the management policies adopted including the outcomes and any due diligence implemented.
- Metrics & Targets – KPIs and targets relevant to the organisation's exposure to climate change risk and opportunity.

The full consultation on requiring mandatory climate-related financial disclosures can be found here.

FCA Review of host Authorised Managers (AFMs)

The FCA published their review in June testing the viability of AFMs business models and whether conflicts of interests were being effectively managed. For this review, the FCA visited AFMs (between Q4 2019 – Q4 2020) to appraise how their governance, controls, and monitoring work to reduce the risks in their business.

The FCA found that a number of firms failed to meet their standards and as such the review sets outs their findings in four sections which firms should consider for their own business:

- Due diligence over delegated 3rd party investment managers and funds
- Oversight of delegated 3rd party investment managers and funds (with clarity that the relationship is differentiated to that of a client)
- Governance and oversight – with a focus on employing senior personnel who are sufficiently experienced
- Financial resources – As per **FG20/1**, firms should consider forward looking financial projections and plans under both business-as-usual and adverse conditions to understand how feasible its business model will be.

As a result of this review, the FCA may look to require regulated firms to hold additional capital to safeguard against risks to their business as well as look to introduce rule changes as needed to their regulatory framework. Sheldon Mills, Executive Director of Consumers and Competition at the FCA, said: "Our review indicates that some firms are not sufficiently meeting FCA standards and we want to see significant improvements in this area". **The full publication can be found here.**

FCA Business Plan 2021/22

The FCA has published its annual Business Plan, which is normally published in April but was delayed until June this year due to the Coronavirus pandemic. The new plan outlines the FCA's aims and approach to being an effective regulator, under the new stewardship of Chief Executive Nikhil Rathi.

The Business Plan is separated into four sections:

1. The FCA's role

The FCA is looking to become more innovative; with £120 million being put forwards to improve its data and technological capabilities as well as £11m being allocated to a digital marketing campaign warning investors of risks in cryptocurrency.

The regulator is also looking to be more assertive and will encourage its partners to take action more readily where issues arise. Included in this section are the following outcomes:

- FCA continuing to push for scam advertising to be included in the Online Safety Bill
- A more stringent approach to maintaining high conduct standards, especially governance, conflicts of interest and diversity/inclusion.
- FCA may consider whether high-net worth investors should afford the same protection as other consumers who are new to investing.

The FCA has also stated that Brexit will bring more freedom to tailor rules to suit the UK market, but that there will also be a focus on strengthening the UK's reputation in the international marketplace. The plan also states that there will be greater cooperation between the FCA, FOS (Financial Ombudsman Service), FSCS (Financial Services Compensation Scheme) and MaPS (Money and Pensions Service) to enable a consistent approach across the board.

2. Consumer priorities

To ensure that firms provide better outcomes for consumers, the FCA are targeting five specific areas:

- Enabling consumers to make effective decisions investments – strengthening the rules on financial promotions and publishing a Consumer Investment Strategy guide.
- Enabling consumer credit markets to work well - monitoring firm's support to clients when they are in financial difficulty. Also looked at reviewing rules on debt advice.
- Making payments safe and accessible – proactive review of firm's CASS arrangements and safeguarding.
- Delivering fair value in a digital age – with a focus on vulnerable clients.
- Proposed new Consumer Duty of Care – Putting customers' best interests first, there is a consultation (CP21/13) on this which closed on 31st July. **Please find it linked here.**

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3. Wholesale markets priorities

The FCA also have a focus on market integrity and are looking at reviewing rules in primary and secondary markets with a focus on tailoring these rules to the UK Markets. There will still be a need to maintain a consistent standard of equivalence to regulations in the EU.

In addition to this, the regulator is looking to tackle market abuse and financial crime by continuing to monitor transaction data reported to the FCA as well as investigating STORs, whistle-blowing reports etc.

Another priority they have stipulated is that firms must complete the switch from sterling LIBOR to alternative risk-free rates and that they must offer products that provide value, meet investors' needs and provide appropriate protections.

The FCA intends to consult on changes to the Appointed Representative (AR) Regime and there are likely to be significant amendments to the regulations here, especially as ARs have been a part of some of the FCA's high profile issues in the past few years.

4. Priorities across all markets

- Diversity and inclusion – FCA will continue to publish its own diversity indicators and Boards should be focusing on this in the coming year with a strategy to make improvements where necessary.
- Environmental, Social and Governance (ESG) – As per previous section there are plans for new disclosure rules as well as adaptations to the FCA framework to enable a transition to net-zero.
- International Priorities – Promoting cooperation with other regulators and the ongoing operation of the Temporary Permissions Regime (TPR).
- Fraud strategy – work with partner organisations to reduce fraud.
- Financial resilience and resolution – IFPR will come into force in the next year. The FCA will also look to monitor and intervene in firms with weak financial resilience.
- Operational resilience – This continues to be a priority with the FCA assessing firms progress in implementing operational resilience requirements as well as assessing their ability to remain within their impact tolerances.

Please find a link to the full FCA Business Plan for 2021/22 here.

Changes to UK MIFID's conduct and organisational requirements (CP21/9)

The FCA published a consultation paper in April looking at changes to two areas of conduct and organisational rules: research and best execution reporting. This follows on from the **Directive (EU) 2021/338** of the European parliament; part of the EU's post COVID-19 capital markets recovery package. The main difference between these two publications is that the FCA are looking at a more significant easing of the rules. This potentially signposts the divergence of UK-EU equivalence.

In this paper, the FCA has proposed to change COBS inducement rules by increasing the list of minor non-monetary benefits which are exempt. These will include research on SMEs with a market cap below £200m and FICC (Fixed Income, Currencies and Commodities) research.

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They have also suggested removing two Best Execution reporting obligations from firms:

- RTS 27 Reports – the obligation on execution venues to publish a quarterly report to compare execution quality at different venues.
- RTS 28 Reports – the obligation on firms to produce an annual report on the top 5 venues for executing orders.

Market participants have in the past reported that RTS 27/28 reports are not useful in deciding which broker to use and as such the change would be a welcome one for many firms.

The consultation closed on 23/06/2021, please find the link to the consultation paper here.

UK Government Taskforce on Innovation, Growth and Regulatory Reform

The Taskforce on Innovation, Growth and Regulatory Reform (TIGRR) submitted its report on the 15th June 2021. The report was put in place by the Prime Minister to look at the UK's approach to regulation following Brexit. The report has the following suggestions with regards to financial services regulation:

- MiFID II position limits – Rather than a hard limit of 25% it is suggested that the US model is followed, and the scope of the regime is being reviewed.
- CCP margins – Again introducing a less strict, more judgement-based approach to calculating central counterparty clearing house (CCP) margins.
- Open Banking / Open Finance – the report recommends following the market-led, Australian style and return to a principles-based approach to Open Finance. This will allow for development of financial dashboards bringing together data from investments, savings etc. in one place.
- Challenger banks – TIGRR recommends a graduated regulatory approach to increase competition in the banking sector
- Anti-Money Laundering (AML) – reduce AML tasks, especially with regards to the scope of the EU AML Directive (AMLD).
- Central Bank Digital Currency (CBDC) – launch a pilot within 12-18 months to ensure the UK does not fall behind internationally.
- MiFID II reports – Removing the obligation for RTS27 & RTS28 reports.
- Market Abuse Regulation (MAR) – Removing the obligation for MAR disclosures for wholesale clients.
- Packaged Retail and Insurance-based Investment Products (PRIIPs) – Only to be produced for genuinely complex packaged products that require special explanations.
- The report also recommends replacing the UK General Data Protection Regulation 2018 (GDPR) with a UK framework of Citizen Data Rights to give people greater control over their data.

Please find the link to the full report here.

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HM Treasury's Wholesale Markets Review: Consultation

Her Majesty's Treasury submitted a consultation on 1st July 2021 looking to review the UK's wholesale capital markets regime, especially as part of the UK's post-Brexit strategy. The paper will be relevant to banks, brokers and asset managers and presents them with an opportunity to influence upcoming changes to the framework.

They have suggested a number of proposals including getting rid of the share trading obligation (which will support cross-border activity) and the double volume cap regime. HMT have also stated they would like to remove the obligations on algo trading firms and trading venues in relation to systems and controls. Furthermore, the consultation suggests a change to exemptions of the commodities regime for hedging practices and liquidity providers.

This consultation will end on 24th September 2021, please find it linked here.

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