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RQC Group Quarterly Regulatory Newsletter October 2020

Introduction

Welcome to our Q3, 2020 newsletter. This is part of a series that aims to provide you with a quarterly update of key regulatory issues affecting the UK/EU and the USA.

In footballing terms the end of the season, when games are completed and trophies won, is sometimes referred to as the 'business end'. To many in the financial services industry, it feels like the last few months of 2020 will represent a 'business end' of sorts.

In Europe, the Brexit implementation period is scheduled to end on 31 December 2020; the continuing uncertainty surrounding this has been well-documented. In the US, the presidential election is likely to dominate proceedings. This election is perhaps the most unusual in recent memory. The past week alone started with a rather raucous debate between the two candidates and ended with the Covid-19-related hospitalisation of one of the candidates; an event which prompted a plethora of conspiracy theories and further political point scoring. Compared to this, the TV series 'House of Cards' resembles a genial political yarn. Whatever the outcome, per the US Constitution, the incumbent President's first (and possibly only) term in office shall end at Noon on 20 January 2021.

At the end of the year, the first anniversary of Covid-19 shall be upon us, the first case having been identified on 31 December 2019.

And yet, these events might not bring the sort of closure associated with winning a trophy or avoiding relegation. There will be a plethora of issues to sort out post-Brexit implementation. The choice of President – and the lie of the land in Congress - might provide some clues as to the future of the US financial services landscape, including the regulatory approach, but without definitive answers. Covid-19 is likely to continue to cause disruption into 2021.

Industry participants have a significant task in grappling with these events. Meanwhile, regulatory initiatives and developments have not fallen by the wayside; we discuss some of the more salient of these in this newsletter.

As ever, we hope that you enjoy reading our newsletter and that you find it helpful. If you have any feedback please share it with your consultant.

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UK/EU - Ongoing Developments

ESG – Going Mainstream

Over the past few years, the acronym 'ESG' has become part of the financial services vernacular. Whilst in the past financial products may have emphasised environmental, social and/or governance factors, the integration of these factors has become mainstream.

To a large degree, this is due to a cultural shift. For instance, younger generations are more likely to embrace environmental issues, and social inequality debates often dominate the newsreels. The financial services industry has positively responded to these trends; recognising behavioural change among investors and consumers. Industry leaders such as Larry Fink, Chair and CEO of BlackRock, the world's largest asset manager, are strong advocates. Mr. Fink has stated "We believe that sustainable investing is the strongest foundation for client portfolios going forward."

Significant global initiatives include the UN global sustainable development framework: the 2030 Agenda for Sustainable Development; and The Paris Agreement, adopted under the United Nations Framework Convention on Climate Change which among other things sets a target of holding the increase in global average temperature to well below 2 degrees Celsius above pre-industrial levels. In tandem, initiatives led by industry bodies and global non-governmental organisations have prompted some financial institutions to adopt certain standards regarding ESG.

For many financial institutions, the commercial imperative to integrate ESG into its operations is now well-established. The next phase is for financial services regulators to set out the rules around this.

In 2018, the European Commission adopted an "Action Plan on Financing Sustainable Growth". This seeks to further connect finance with sustainability by setting out actions that can be divided into three categories:

- Reorienting capital flows towards a more sustainable economy;
- Mainstreaming sustainability into risk management; and
- Fostering transparency and long-termism.

Pursuant to this, the European Commission adopted a package of measures, covering disclosures relating to sustainable investments and sustainability risks, the creation of a united classification system on what can be considered an environmentally sustainable economic activity, the creation of a new category of benchmarks comprising low-carbon and positive carbon impact benchmarks, plus amendments to pre-existing legislation including the Markets in Financial Instruments Directive ("**MiFID**") and the Alternative Investment Fund Managers Directive ("**AIFMD**").

Significantly, these measures have the potential to impact on firms that do not have a specific focus on ESG. For example, a fund manager that employs strategies where ESG is not a core focus but is factored into investment decision-making and risk management, will be impacted.

Certain legislative requirements take effect from 2021 onwards. Set out below are some key considerations for asset managers

1. The "Sustainable Finance Disclosure Regulation" ("SFDR") – disclosing to end investors

Published in December 2019, certain elements of SFDR take effect in March 2021. SFDR requires firms – including MiFID investment firms, alternative investment fund managers and UCITS managers - to make various disclosures on their website and in documentation related to a financial product, as well as ensuring that marketing materials do not contradict these disclosures.

Firms are required to make a number of disclosures, as set out below:

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FIRMS WILL NEED TO DISCLOSE:

Website	Policy on the integration of sustainability risks into investment decision/making process/ investment advice	10-Mar-21
	Either: Statement on due diligence policies with respect to principal adverse impacts of investment decisions on sustainability factors; OR If not considering adverse impacts of investment decisions on sustainability factors, clear reasons for why not doing so (Comply or explain)	10-Mar-21
	Remuneration policy with information on how those policies are consistent with the integration of sustainability risks	10-Mar-21
	Either: Where firm has adopted sustainability due diligence policies, a statement on how each product considers principal adverse impacts on sustainability factors; OR a statement that the firm does not consider adverse impacts and the reasons why (Comply or explain)	30-Dec-22
Pre-contractural disclosure	Either: Integration of sustainability risks into investment decisions, and the results of impact assesment of sustainability risks on the returns of each financial product; OR If sustainability risks are deemed not to be relevant, a clear and concise explanation of the reasons therefor (Comply or explain)	10-Mar-21
	IF the firm has implemented a sustainability due diligence policy, disclose how each product considers principal adverse impacts on sustainability factors (Comply or explain)	30-Dec-22
Periodic disclosures	Firms that implement sustainability due diligence policies, shall publish an Adverse sustainability impacts statement by 30 June each year.	30-Jun-22
	There will be additional Disclosures for financial products, e.g. funds, promoting sustainability or with a sustainable investment objective, including periodic reports.	

2. “Taxonomy Regulation” – setting the parameters

The Taxonomy Regulation will establish a framework for determining the environmental sustainability of an economic activity. It applies to firms offering financial products and to large, EU-listed public companies.

In order for an activity to be an “environmentally sustainable economic activity”, it must:

A. Make a “substantial contribution” to at least one of six “environmental objectives”:

(i) Climate change mitigation
(ii) Climate change adaption
(iii) Sustainable use and protection of water and marine resources
(iv) Transition to a circular economy
(v) Pollution prevention and control
(vi) Protection and restoration of biodiversity and ecosystems

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B. Not "significantly harm" any of the other environmental objectives

C. Meet "minimum safeguards", such as complying with the OECD's Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.

In addition, it must comply with other criteria to be set out in Technical Standards that will accompany the Taxonomy Regulation.

The Taxonomy Regulation entered into force in July 2020. With respect to environmental objectives (i) and (ii) above, it takes effect on 1 January 2022. For the remaining environmental objectives it takes effect on 1 January 2023.

3. Amendments to AIFMD, UCITS and MiFID II

In June 2020, the European Commission published amendments to the AIFMD, UCITS and MiFID II frameworks that are scheduled to take effect in late Q3 or early Q4, 2021.

The requirements include:

- Organisational requirements: take into account sustainability risks when complying with organisational requirements;
- Conflicts of interest: identify conflicts which may arise from the integration of sustainability, or a client's sustainability preferences;
- Investment risks: take into account sustainability risks when investing (AIFMs and UCITS managers);
- Suitability: take into account a client's individual ESG preferences when making recommendations to clients (MiFID investment firms); and
- Product governance: manufacturers and distributors of financial products to take account the sustainability preferences of an identified target market (MiFID investment firms).

Next Steps

ESG is shaping up to be an important topic. Over the next few years, evolving commercial and regulatory considerations shall further align; this is not merely compliance for compliance's sake but an opportunity for firms to demonstrate to stakeholders that they are doing things correctly.

In the first instance, affected firms should consider the disclosure measures that should be put in place by 10 March 2021. This includes amendments to a firm's website, fund documentation and marketing materials; as well as the adoption of new internal policies and practices.

Proposed changes to AIFMD delegation – a dig at the UK, or an opportunity to recalibrate regulatory risk?

When drafting and finalising the Alternative Investment Fund Managers Directive ("**AIFMD**"), one of the hot topics concerned 'delegation' – the extent to which an alternative investment fund manager ("**AIFM**") is able to delegate its functions. There was much chatter about 'letterbox entities'. Eventually, EU legislation set out that an AIFM cannot delegate the performance of investment management functions (portfolio management and risk management) to an extent that exceeds by a substantial margin the investment management functions performed by the AIFM itself.

The asset management industry assessed the delegation requirements and came up with a structure that shares certain characteristics with a pre-existing model for UCITS funds – the AIFM management company. Under this arrangement, portfolio management is delegated to a third party investment manager, with the AIFM management company retaining risk management, and being responsible for a number of other logistical aspects. On the premise that portfolio management and risk management have equal weighting, the 'substantial margin' criterion is not met; therefore the AIFM management company is not a letterbox entity.

A review of AIFMD by the European Securities and Markets Authority ("**ESMA**") could lead to a collision course with this framework. In a letter to the European Commission dated 18 August 2020, ESMA opines that greater clarity on delegation requirements is needed.

ESMA queries the 'substantial margin' criterion by implying that under a delegation arrangement, a majority of human and technical resources are maintained by the delegate, or other third parties, aside from the AIFM. Hence, most of the management fees flow to these third parties. Furthermore, questions are raised as to whether the AIFMs are able to effectively supervise the delegates, and whether the AIFMs are 'effectively managing' the AIFs.

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ESMA proposes a number of solutions to address this, including:

- Detailing a list of core or critical functions that must always be performed internally and may not be delegated to third parties;
- Ensuring delegation does not result in 'regulatory arbitrage' i.e. where the regulatory framework in the domicile of the delegate is not as robust as in the EU;
- Limit the usage of staff 'seconded' from the delegate to the AIFM; and
- Clarifying which 'supporting tasks' (e.g. legal and compliance) are subject to delegation arrangements.

One take on this is that the ESMA opinion has political undertones since a very common arrangement is an EU based AIFM management company delegating portfolio management to a UK based investment manager. This is hence seen as being part of a 'Brexit play' to weaken the UK asset management industry.

Such arguments can, however, be countered in a number of ways.

Firstly, the delegation arrangements are not confined to the EU and the UK. Portfolio management can be delegated to investment managers in other countries – the US, Hong Kong, Singapore and Australia, for example. Would the EU's financial services regulator (which is ostensibly non-political) really endanger these relationships just to 'get at' the UK?

Secondly, the AIFM management company set-up has become a well-established industry in certain EU countries, in particular Luxembourg and Ireland. There is little incentive for these countries to rock the boat too violently.

Thirdly, the opinion by ESMA is just that – an opinion. It still needs to be considered by the European Commission. Any process to turn this into enacted legislation would be glacial. Perhaps – just perhaps - we would have moved on from the Brexit bickering by then.

This letter closely followed an indication from the European Commission that an equivalence decision on the UK regulatory environment (which would facilitate cross-border financial services activity between the UK and the EU) will not be forthcoming in the short or medium term. It's therefore tempting – and makes a nice newspaper article – to state that ESMA and the European Commission are acting out a 'pincer movement' on the UK.

More likely, ESMA's letter – which covers a number of suggestions on improving AIFMD, aside from delegation related improvements – just happened to coincide with a particularly testing phase of the Brexit negotiations.

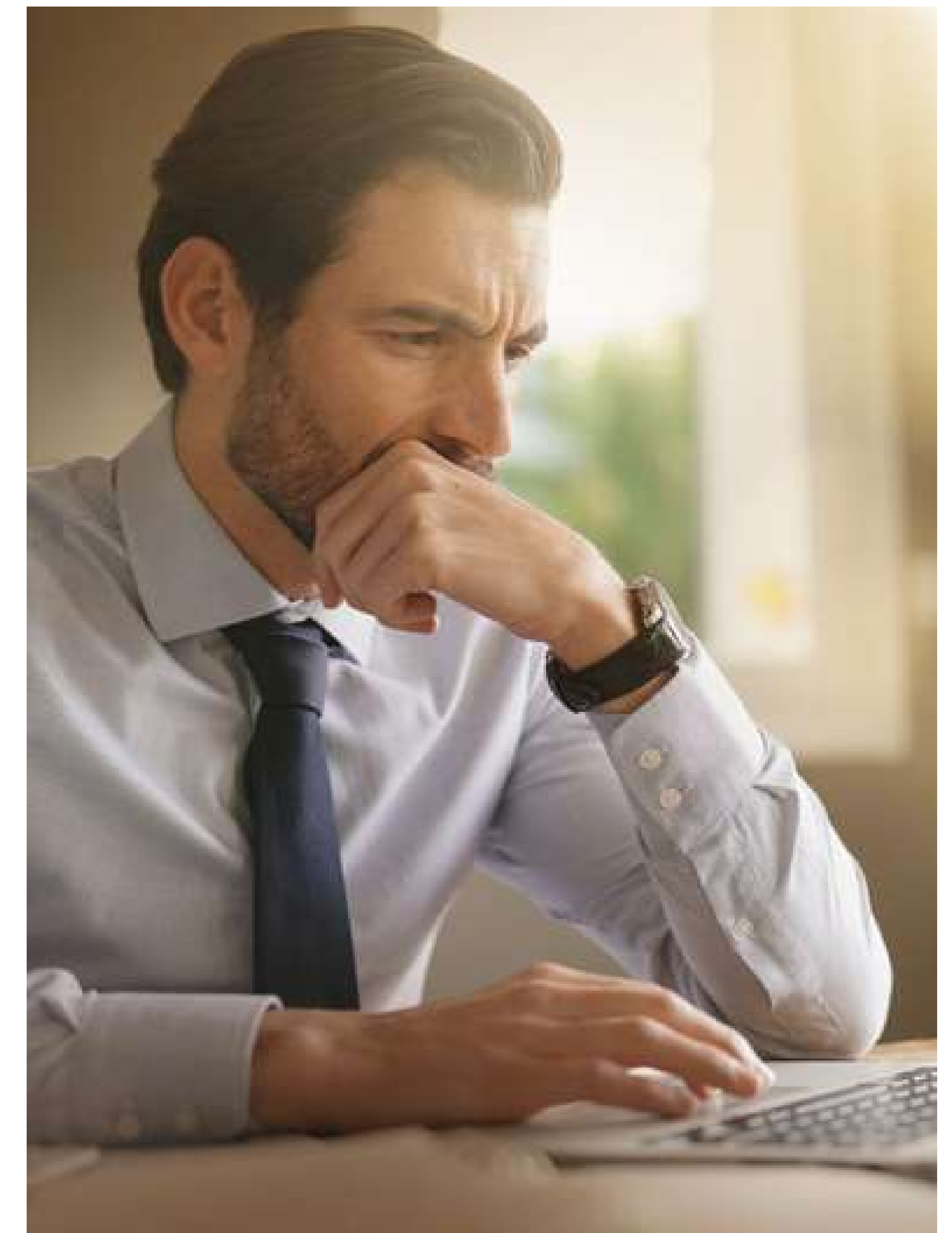
SMCR and Regulatory Expectations

The first anniversary of the commencement of the Senior Managers and Certification Regime ("**SMCR**") for so-called 'solo-regulated firms' is looming fast. This is an integral component in a major regulatory initiative to improve conduct and culture at financial institutions. Under SMCR, senior managers and other key staff are subject to enhanced individual accountability, with respect to both the manner in which they discharge their role and responsibilities and how they run the parts of the firm for which they are responsible.

Earlier this year, and for Covid-19-related reasons, the expiration of the SMCR 'transitional period' was recently extended by the UK Financial Conduct Authority ('FCA') from 9 December 2020 to 31 March 2021. By this date, firms are required to train all staff on the conduct rules, issue certificates to certification function holders and ensure that details of relevant individuals are published in the FCA Directory.

This provides firms with greater flexibility with respect to when they can complete these tasks. Firms have the option of completing these tasks in advance of the deadline, and many have already done so. Alternatively, firms can use the extra time in order to ensure that they complete them properly and effectively.

To assist firms and set regulatory expectations, the FCA has provided 'positive indicators' and 'negative indicators' with respect to transitional and recurring tasks, focussing on: (i) fitness and propriety assessments for Senior Managers and Certification Staff; and (ii) conduct rules training.



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(i) Fitness and propriety

There is a requirement to conduct the initial fitness and propriety ("**F&P**") assessment for Certification Staff by 31 March 2021. There is also an existing requirement to conduct fitness and propriety assessments for Senior Managers.

The FCA considers the following to be 'positive indicators':

- Senior Managers actively oversee the F&P processes;
- F&P checks identify new issues with staff, as opposed to this being a 'rubber stamping' exercise;
- The competence assessment considers the characteristics of the role performed by the individual;
- Training and development plans are put in place;
- Relevant staff members understand the F&P process and what is expected of them;
- F&P is integrated into HR and performance management processes;
- Certification staff are identified on an ongoing basis; and
- Regulatory references disclose relevant concerns and are produced in a timely manner.

(ii) Conduct rules training

The FCA emphasises the importance of appropriate and effective conduct rules training. This is considered an integral part of a firm's overall compliance training programme. The conduct rules represents minimum standards for individuals working in the financial services industry and therefore they set the foundations upon which such individuals conduct their role and responsibilities.

Therefore, the training should be:

- Interactive and use realistic scenarios that are relevant to the individual's responsibilities;
- Reinforced regularly, not just when the individual joins the firm;
- Presented as a 'step change' in regulatory expectations; and
- Linked to performance assessments.

In addition, the Senior Manager responsible for conduct rules training must be able to demonstrate appropriate involvement in and oversight over the training.

By the end of 2020, many firms will have submitted their inaugural 'REP008' return to the FCA. This discloses conduct rule breaches that resulted in disciplinary action to the regulator, for all staff subject to the conduct rules aside from senior managers. This essentially covers the SMCR 'bedding

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down' period covering December 2019 and 2020. Whilst we predict that most submissions will be 'nil' returns, we also envisage that the number of 'nil' returns will diminish, as processes for breaching conduct rules are embedded into firms' HR and compliance frameworks.

The FCA has made it very clear that SMCR is not a 'box ticking' exercise, and the REP008 return serves as a reminder of the ramifications of breaching conduct rules (for individuals) or – potentially – not doing enough to prevent conduct rule breaches (for firms). Although SMCR has been with us for some time, firms should continue to make best efforts to lay the right foundations.

European Securities and Markets Authority ("ESMA") Round-up

- **Draft rules for third-country firms under new MiFID and MiFID II regimes**

ESMA has published its final report, "Draft technical standards on the provision of investment services and activities in the Union by third-country firms under MiFID II and MiFIR".

The EU's Investment Firms Regulation and Directive, which take effect in 2021, shall introduce changes to MiFID II and MiFIR regimes for the provision of investment services and activities in the EU by third-country firms. This includes new annual reporting requirements from third-country firms to ESMA. In addition, the possibility for ESMA to ask third-country firms to provide data relating to orders and transactions in the EU is explicitly mentioned.

The report sets out technical standards that specify:

- The information that third-country firms must provide to ESMA for the registration in the ESMA register of third-country firms, and the information that third-country firms have to report annually to ESMA; and
- The format in which the information for the registration of the firm and for the annual report to ESMA should be submitted.

With respect to EEA branches of third-country firms authorised under MiFID II, the Investment Firms Directive amends MiFID II to provide for further reporting obligations on such branches to national regulators. The technical standards specify the format of such reporting.

The European Commission has until 28 December 2020 to decide whether to adopt the technical standards.

- **Transaction reporting review - including extending obligations to AIFMs**

ESMA has published a consultation paper, "MiFIR review report on the obligations to report transactions and reference data".
This publication is part of a process requiring the European Commission to present a report to the European Parliament and Council to assess the functioning of the MiFIR transaction reporting regime.

The publication covers the following aspects of the MiFIR transaction reporting regime:

- UCITS management companies and AIFMD: **it is recommended that the transaction reporting regime is extended to UCITS management companies and AIFMs that are performing equivalent services to MiFID investment firms (for example, the so-called 'top-up' permissions per Article 6(4) of AIFMD);**
- Scope of instruments subject to reporting obligations;
- Details to be reported (including with respect to trading venue, transaction identification, chain of transactions, the identifiers to be used for parties, computer algorithms and short sales);
- Obligations for investment firms transmitting orders;
- Entities entitled to provide transaction reports to national regulators;
- Interaction with the reporting obligations under EMIR; and
- LEI of the issuer of the financial instrument.

EMSA is inviting comments on the publication, which should be provided by 20 November 2020.

- **ESMA finds that MiFID II 'unbundling' is not harmful**

ESMA has conducted an in-depth study of 8,000 EU companies, analysing the impact of 'unbundling' on sell-side research.

'Unbundling' was introduced by MiFID II in January 2018, and requires firms to pay for research separately from execution, either by charging its clients or via self-payment.

ESMA found that the number of analysts used by firms to conduct research did not materially change following the implementation of MiFID II, and that research quality has not been impacted.

Furthermore, whilst the number of companies losing research coverage has been steadily falling since 2012, MiFID II has not impacted upon this.

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- **Review of the Market Abuse Regulation**

ESMA's review of the Market Abuse Regulation ("**MAR**") is the first in-depth review of the functioning of MAR since its implementation in 2016.

The review concludes that, overall, MAR has worked well in practice and is 'fit-for-purpose', and the recommendations focus on specific amendments and clarifications rather than a major overhaul.
The proposed amendments include:

- Clarifying that the MAR requirements regarding market soundings represent an obligation for disclosing market participants that, if complied with, will protect them from the allegation of having unlawfully disclosed inside information; and
- Regarding benchmark provisions, clarifying the responsibility of management companies of collective investment undertakings in relation to the disclosure of inside information.

ESMA suggests providing additional guidance with respect to inside information and disclosure and pre-hedging i.e. whether specific pre-hedging conduct poses market abuse risks.

The report has been submitted to the European Commission and is expected to feed into the Commission's review of MAR.

Enforcement and Financial Crime – Round-up

- **FCA Enforcement data for 2019/20**

The FCA has published data showing the enforcement action it took in 2019/20.

The total value of fines has decreased very slightly, from £227.3 million in 2018/19 to £224.4 million in 2019/20. In addition, c. 46% of the total amount for 2019/20 relates to a £102.2 million fine against Standard Chartered Bank over money laundering.

Markedly, there is a significant decrease in the total value of fines against individuals. This is due to a large fine (£76 million) against a single individual in the previous year.

As at 31 March 2020 there were 646 open enforcement cases covering a number of areas including financial crime, wholesale conduct, insider dealing, market manipulation and unauthorised business activity.

During the year, the FCA cancelled the permissions of 171 firms and prohibited 6 individuals.

- **Money laundering and terrorist financing – virtual assets**

In September 2020 the Financial Action Task Force, a global anti-money laundering and anti-terrorist financing policy-making body, published a report on red flag indicators of money laundering and terrorist financing, related to virtual assets.

The report suggests that due to the anonymity and innovative technology associated with virtual assets, it may be more difficult to identify suspicious activity.

It also sets out categories of red flag indicators that could potentially indicate suspicious transaction or other illicit activity, including:

- Technological features that increase anonymity;
- Geographical risks of dealing in virtual assets in countries that lack of have less stringent regulation of such assets;
- Unusual virtual asset transaction patterns, sources or funds or wealth and instances where the amount and/or frequency of the transactions lack, or are inconsistent with, a stated business purpose; and
- Irregularities observed in the profiles of senders and recipients of virtual assets or other unusual behaviour by parties to a virtual asset transaction.

- **Listings of cannabis-related businesses**

The FCA has set out its approach with respect to cannabis-related companies interested in listing in the UK.

In particular, this sets out the risk that a medicinal cannabis business might be conducting 'criminal activity'.

Medicinal cannabis was legalised in the UK in 2018. However under the UK Proceeds of Crime Act, 'criminal conduct' has a wide meaning and includes conduct outside of the UK that would be criminal in the UK if carried out in the UK. This includes where a non-UK firm is supplying medicinal cannabis in the UK without the appropriate Home Office licences.

For this reason, the FCA advises the medicinal cannabis companies may be admitted to the Official List, provided the FCA is satisfied that the Proceeds of Crime Act has not been breached.

In any event recreational cannabis companies cannot be admitted to the Official List, since this remains a criminal offence in the UK.

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UK/EU - Regulatory News

European Commission publishes report ESMA's liquidity guidelines for UCITS and AIFs

30 Sept 2020

The European Securities and Markets Authority's ("**ESMA**") 'Guidelines on Liquidity Stress Testing in UCITS and AIFs' (the 'Guidelines') took effect on 30 September 2020.

The Guidelines apply to alternative investment fund managers (AIFMs) and UCITS management companies that are subject to the liquidity management provisions detailed in AIFMD and the UCITS directive respectively.

The legislation sets out that the aforementioned firms are required to perform liquidity stress testing ('**LST**'). The Guidelines build upon this by providing further direction with respect to a number of aspect of LST including:

- Designing LST models;
- Governance;
- Characteristics of the LST policy;
- LST frequency;
- LST outcomes;
- LST scenarios;
- Product development;
- Stress testing fund assets and fund liabilities; and
- LST with respect to less liquid assets.

In addition, there is a requirement for fund depositaries to set up appropriate verification procedures to check that a fund manager has in place documented procedures for its LST programme.

The Guidelines state that National Competent Authorities (i.e. national regulators) and financial institutions should make every effort to comply with these Guidelines.

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Temporary Permissions Regime is now back open

30 Sept 2020

The FCA has reopened CONNECT for temporary permissions regime notification forms. Notifications should be made by:

- Inbound firms looking to continue operating in the UK within the scope of their passport permission (as it stands at the end of the transition period) while seeking full UK authorisation, if required;
- EEA UCITS funds wishing to continue marketing in the UK while seeking UK recognition; and
- EEA and UK AIFs that were marketed in the UK by EEA fund managers and would like to continue to be marketed in the UK for a limited period during which time the fund manager will need to notify the FCA under the relevant legislation.

Firms have until 30 December 2020 to make notifications. Firms who have previously made notifications have until 14 December 2020 to provide updates.

Further information: https://www.fca.org.uk/brexit/temporary-permissions-regime-tpr

Coronavirus and 10% depreciation notifications: further temporary measures for firms

30 Sept 2020

The FCA has previously stated in a "Dear CEO" letter to firms providing services to retail investors, from 31 March 2020, that they would allow supervisory flexibility over the 10% depreciation notifications until 1 October 2020.

Firms providing portfolio management services or holding retail client accounts that include leveraged investments are currently required to inform investors where the value of their portfolio or leveraged position falls by 10% or more compared with its value in their last periodic statement, and for each subsequent 10% fall in value.

The FCA has confirmed that it will not take action against firms that breach this notification required to retail investors from 1 October 2020 if it fulfils certain conditions, such as whether a client has been notified at least one other time during the reporting period about a 10% drop and the firm has informed the client that it may no longer receive these notifications.

For firms with professional investors, the FCA will not take actions for a breach of the 10% depreciation notification requirements if firms have allowed professional clients to opt-in to receive such notifications.

These amendments will be in place for the next 6 months (until 30 March 2021).

FCA update following the recent coronavirus restrictions statements on Tuesday 22 September

24 Sept 2020

Following announcement of further restrictions by the UK government the FCA made the following statement:

"All firms should be clear that coronavirus (Covid-19) continues to pose a significant risk to public health. As the regulator of the UK financial services industry, we wish to remind firms that the Government is again asking workers who can work from home to do so.

Firms should continue to discuss working arrangements with staff and support their employees in facilitating appropriate working arrangements as the coronavirus pandemic continues and the situation evolves. This includes when working from home or within a workplace.

We expect Senior Managers to take account of changes in the applicability of local or national lockdown restrictions and to review and update the working arrangements they have in place with their employees on a continuing basis. Ultimately, Senior Managers should be aware of and act on lockdown restrictions as set out by national authorities, and relevant local authorities where their staff are based.

Firms should continue to follow the Government's advice closely and take the recommended steps."

LIBOR Transition Webpage

17 Sept 2020

The FCA published a webpage on 17 September 2020, with advice for firms on the LIBOR transition. Boards and Senior Managers should undertake an inventory of LIBOR exposure, and ensure that their firms are ready to move away from LIBOR before the end of 2021. Inventory should be covering all processes and systems, including (as relevant) pricing, valuation, risk management and booking. It should also cover contracts with clients, counterparties, creditors, employees, suppliers and others.

The FCA recommends Firms to familiarise themselves with the LIBPR transition path and statement, by the Working Group on Sterling Risk Free Reference Rates (RFRWG) which is supported by both the FCA and Bank of England.

The new webpage contains information and actions that should be considered by all firms. There is also additional information relevant for specific firms based on the activities they undertake. These firms include but are not limited to, firms undertaking asset management, corporate finance (and similar) advice and principal trading.

The webpage will be periodically updated with information for affected firms ahead of the end of 2021.

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FCA publishes Market Watch 65

07 Sept 2020

In its latest Market Watch (September 2020), the FCA sets out three topics: confidentiality of information requirements; legally privileged documentation; and transaction reporting.

Regarding the first topic, the regulator sets out how its information requests under the Financial Services and Markets Act 2000, sections 122B, 165(1) and 173, are requests that assist in its work against market abuse. The FCA underlines that these information requests are meant to be strictly confidential, and not discussed with anyone outside the Compliance team other than in certain circumstances. If the Compliance team considers that is needs to talk to another department or team, it should discuss with the FCA first to avoid prejudicing any investigation or inappropriate dissemination of enquiries, including tipping off a suspect. Therefore, should the Compliance team speak to any other members of staff, it is important to make clear that staff must not in their turn contact other members of staff and that the information is a confidential request from the FCA.

With a slight link to the first topic, the second topic of Market Watch 65 is legally privileged documentation. The FCA is letting firms know, that they are seeing material relating to firms' clients that could be subject to legal professional privilege attached to suspicious transaction reports.

There are two kinds of legal professional privilege, Litigation Privilege and Legal Advice Privilege. The FCA stresses that any material that could be subject to legal professional privilege should not be submitted with a Suspicious Transaction and Order Report ('**STOR**') or quoted from in a STOR, as the information disclosed may be waived or lost in an enforcement case.

Lastly, Market Watch 65 continues to look at transaction reporting. The regulator continues to closely oversee the transaction reporting regime, and to highlight quality issues. In this newsletter, four issues are being highlighted as described below.

Unreported transactions

Some firms have misinterpreted requirements to report transaction executed in non-EEA listed indices or baskets composed of one or more financial instruments admitted to trading on an EEA trading venue. The regulator has also identified investment firms executing transactions in reportable financial instruments while not having the infrastructure in place to submit transaction reports no later than the close of the following working day. The FCA expects firms to report such breaches promptly, and not delay submission of a notification until the issue has been resolved

The immediate underlying

For transactions executed in derivatives and other financial instruments with an underlying, the underlying instrument code (RTS 22 (technical standards related to transaction reporting); Field 47) should be reported with the ISIN of the immediate underlying instrument. The FCA observes transaction reports where the 'ultimate' underlying instrument has been identified and erroneously used to determine whether the financial instrument is in scope for transaction reporting.

Trading venue transaction identification codes

Trading venue transaction identification codes ("**TVTICs**") are generated by trading venues and disseminated to the buying and selling parties for transactions executed on a trading venue.

The FCA notes that there is inconsistent dissemination of TVTICs by trading venues to investment firms. Trading venues should review their procedures for the generation and distribution of TVTICs.

The FCA also notes that some investment firms are failing to report the TVTIC accurately, e.g. by leaving the field blank, reported with an internal code, or reported with a code that fails to follow any guidelines provided by the respective trading venue

Country of branch fields

The country of branch for the buyer (Field 8) and seller (Field 17) should only be populated where the buyer or seller was a client of the firm. In that scenario, the respective field should be reported with the country code of the branch that received the order from the client (or made an investment decision for the client in accordance with a discretionary mandate given to it by the client).

Systems and controls

The FCA takes the opportunity to remind firms that they should not assume that transaction reports are accurate because they are accepted by the FCA. The FCA's validation rules for accepting a report are not designed to capture all errors and omissions, and firms should ensure that their reports are accurate and complete.

Further, the FCA reiterates that firms are required under Art 15(3) of RTS 22 to download data extracts from the system to reconcile transaction reports with front office data.

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Investment firms should also consider whether they have sufficient understanding of the requirements to identify errors where front office reconciliation might not do so, such as reporting trade time in BST or price in pence rather than pounds.

Finally, the FCA stresses that back reporting is critical and that it expects firms to take all steps to ensure all reports affected by an error or omission is identified and corrected. The FCA reminds firms that the same transaction reference number should be used for a corrected report.

See more information on the FCA's website:

https://www.fca.org.uk/markets/transaction-reporting

FCA Publishes Market Watch 64

27 August 2020

This edition of the FCA Market Watch newsletter series looks to provide important information for firms to consider in preparation for Brexit. Whilst transitional powers will be in place for certain regimes, the FCA has clarified that it expects that firms to have procedures in place to ensure continuity of reporting from 31 December 2020. In addition, firms are signposted to relevant FCA Brexit webpages, for example in relation to MiFID transparency regime as well as industry testing for the FITRS (Financial Instruments Transparency System) and FIRDS (Financial Instruments Reference Data System) will open on 5 October 2020.

Extension of Annual Financial Crime Reporting Obligation

24 August 2020

In 2016, the FCA introduced an annual financial crime reporting obligation (REP-CRIM return) for certain firms, based on either their

regulated activity or total revenue. The FCA is proposing to expand the scope of firms required to provide an annual REP-CRIM return. Firms to be pulled into the increased scope of reporting are those deemed to pose a potentially higher money laundering risk and will include firms that have permission to hold client money or assets as well as certain payment institutions, multilateral trading facilities, organised trading facilities and cryptoasset exchange and wallet providers. In addition, firms currently in scope of REP-CRIM due to the provision of home finance mediation or making arrangement with a view to transactions in investments will no longer considered to be in scope.

Comments on this proposal can be submitted to the FCA by 23 November 2020.

EFAMA calls for Level 1 review of PRIIPS and extension of the UCITS exemption

04 August 2020

On 4 August 2020, the European Fund and Asset Management Association ("**EFAMA**") issued a letter to the European Commission on the subject of the Packaged Retail and Insurance-based Investment Products ("**PRIIPs**") draft Regulatory Technical Standards ("**RTS**"), calling for an immediate extension of the Undertakings for the Collective Investment of Transferable Securities ("**UCITS**") exemption in addition to an urgent Level 1 review of the regulation.

According to EFAMA's press release, European Supervisory Authorities ("**ESAs**") have recently issued a communication to the European Commission, stating that the ESAs are unable to agree on a revised PRIIPs draft RTS.

EFAMA acknowledges that the ESAs have tried to find a solution to address the flaws of the PRIIP KID, which EFAMA states leads to "suboptimal disclosures" for retail investors.

However, EFAMA agrees with ESAs that this cannot be solved via

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technical changes at the Level 2 regulations. Instead, EFAMA calls for an immediate Level 1 review, as mandated by the PRIIPs regulation.

EFAMA has also requested an extension for UCITS to have to start producing a KID (currently from 1 January 2022) until after any issues with the PRIIPs regime have been resolved.
See also EFAMA's press release of 5 August 2020.

ISDA and several industry associations publish joint letter warning of Brexit cliff edge.

31 July 2020

ISDA and several industry associations publish joint letter warning of Brexit cliff edge.

The International Swaps and Derivatives Association ('ISDA'), together with the Italian Financial Markets Intermediaries Association (Associazione Intermediari Mercati Finanziari, or 'ASSOSIM'), the Danish Securities Dealers Association (Børsmæglerforening Danmark), the European Banking Federation and the Swedish Securities Dealers Association (Svenska Fondhandlareföreningen) have published a paper in response to concerns about the impact on EU and UK firms and their EU and UK clients resulting from the end of Brexit transition period in December.

The industry associations are mainly concerned with the markets and regulations concerning OTC derivatives business but recognise these effects will impact many actors in the financial services.

The letter considers that, much like the situation was in 2018, before the parties had agreed a withdrawal agreement and a transition period, the current end of the transition period risks creating a cliff edge with respect to OTC derivatives.

In June 2020, the European Commission published a communication considering a time-limited equivalence decision with respect to UK central counterparty clearing houses ("**CCPs**").

However, there are a number of areas where the Commission hasn't adopted an equivalence decision in relation to the UK, including the equivalence decisions under Art 47(1) MiFIR (for investment firms providing investment services to EU professional clients and eligible counterparties). This in turn will have repercussions for all market participants, whether they are active in the OTC derivatives markets or not.

Solely in terms of non-equivalence of UK CCPs under EMIR, the industry associations identify a number

of issues that will lead to adverse effects: "higher costs (including but not limited to a significant increase in the capital requirements of EU institutions under CRR in respect of their exposures to UK CCPs after the end of the transition period envisaged by CRR), increased systemic risk and distorted competition in global derivatives markets and CCPs".

The industry associations urge the Commission and EU national competent authorities to extend existing exemptions to UK entities, adopt equivalence decisions and approve applications, to allow both EU and UK entities to continue to serve market participants and clients, without a cliff edge in January 2021.

See more here:

https://www.isda.org/a/LM9TE/Brexit-Cliff-edge-Issues.pdf

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European Commission proposes amendments to MiFID II

30 July 2020

The European Commission has published proposals (dubbed the "Quick Fix" proposals) to amend clauses regarding information requirements, product governance and position limits to help capital market participants recover from the COVID-19 pandemic. Whilst COVID-19 is cited as cause for change, a number of issues raised in previously consultations have been brought into scope of review and amendment. Whilst some of the changes will bring much needed relief for firms, others are limited due to their application.

Changes currently proposed include:

- Phase-out of paper-based default method for communication: It is seen that paper-based statements and investor reports, particularly in the banking industry, have become superfluous a digital world.
- Ex-post statements: MiFID II requires investment firms to send ex-post statements to clients concerning the services they have received. It is proposed that eligible counterparties and professional clients should be exempted from receiving the ex-post statements all together. Professional clients, however, can opt-in for continued service reports. These reports include the loss-reporting reports that are triggered by 10% portfolio losses which has been deemed useful for clients given recent COVID-19 induced market volatility.
- Costs and charges: proposals put forward will allow an exemption for eligible counterparties and professional clients from the costs and charges requirements where other services than investment advice and portfolio management are concerned. Therefore, this exemption is limited, with advisers and investment managers continuing to be required to provide costs and charges information to clients.
- Best Execution Report: The temporary suspension of the RTS 27 reporting requirement for execution venues has not been extended to the RTS 28 reporting requirement for firms.
- Product governance: It is proposed that product governance requirements will not apply to simple corporate bonds with make-whole clauses.
- Research: Where research is provided to small and mid-cap issuers on fixed-income instruments, inducements rules may be alleviated and an option given for firms to apply rules already in place.

It is to be seen if the UK will adopt such a change given the work previously undertaken to unbundle research and execution costs. At this time, it is expected that such changes will not take effect until after 31 December 2020 and therefore application to UK firms is currently uncertain

The Joint Money Laundering Steering Group ("JMLSG") publishes new sectoral guidance for cryptoasset exchange providers and custodian wallet providers.

27 July 2020

The new sectoral piece forms a new section (22) within Part II of the JMLSG guidance.

It sets out definitions of cryptoassets, wallet providers and the like, as well as defining the AML/CFT risks of this sector. The perceived risks are based on assessments made by the National Crime Agency ("**NCA**"), the latest of which is its 2020 assessment. In this, the NCA found that previously identified trends had become more prevalent, including UK based criminals identifying new ways to use virtual assets for financial crime, including money laundering.

Paragraph 22.33 of the guidance identifies factors that contribute to the risk of the sector, including but not limited to, privacy/anonymity, cross-border nature, digital nature, and acceptability.

22.34-22.35 contains further risk factors to be considered;

22.36-22.40 sets out risk assessment methods, and 22.41-22.62 risk mitigation suggestions.

FCA launches enhanced Financial Services Register

27 July 2020

On 27 July 2020, the FCA published a press release announcing the launch of its enhanced Financial Services Register. https://www.fca.org.uk/news/press-releases/fca-launches-enhanced-financial-services-register-protect-consumers

The redesign of the register aims to make it easier for users to navigate and understand the information it contains. Key enhancements include:

- Clearer navigation and design.
- More information on the register's purpose, how to use it, and how to avoid scams.
- Information being made more prominent, including past actions against individuals and firms, and consumer protections.

The press release also confirms that the FCA intends to publish its directory of certified and assessed persons on the register later in 2020.

The FCA will review and improve the register on an ongoing basis to ensure it meets the needs of users.

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UK/EU - Enforcement

FCA publishes Decision Notice against Corrado Abbattista for market manipulation

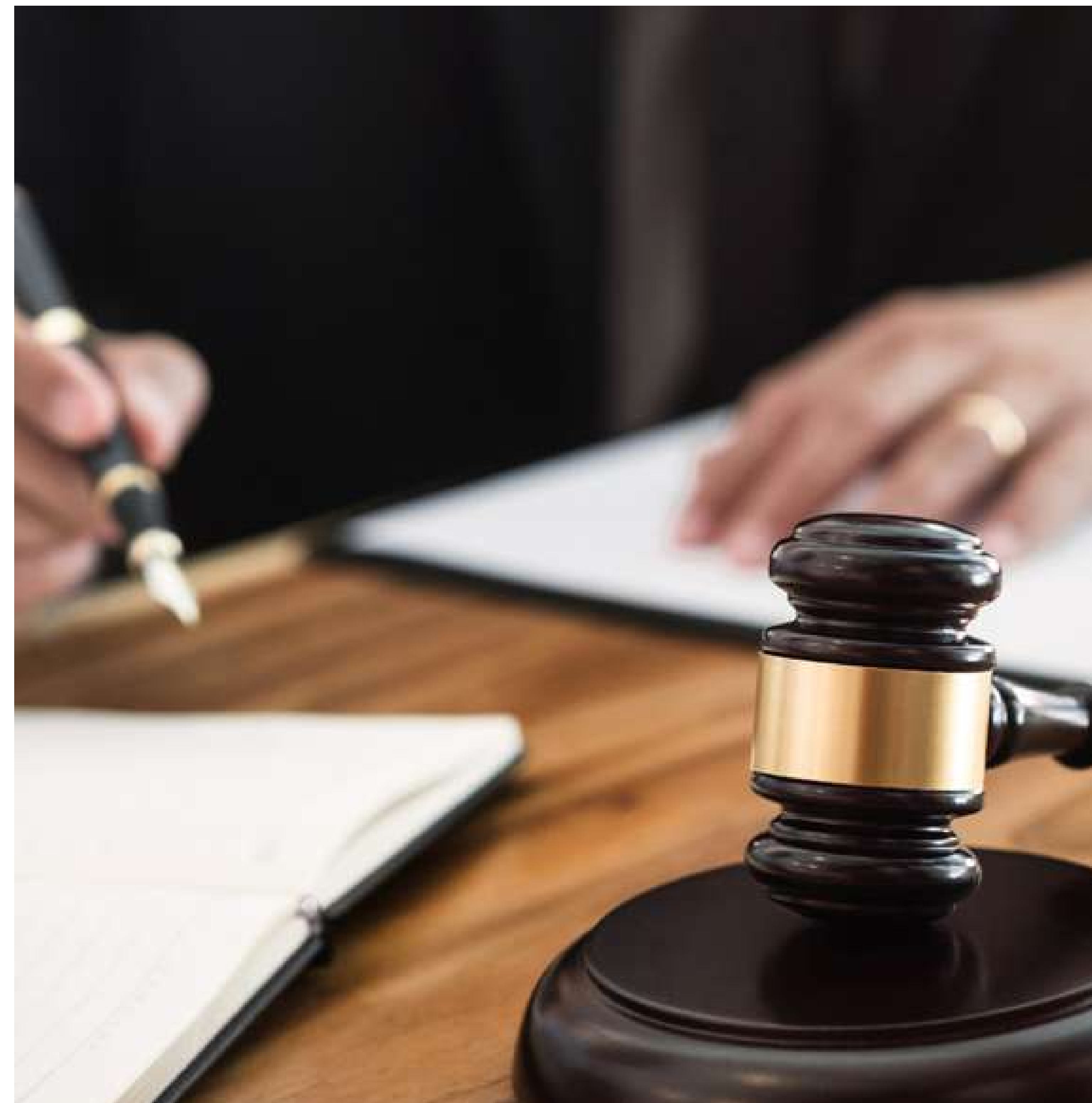
16 September 2020

The FCA published a Decision Notice on 16 September 2020 with respect to Corrado Abbattista, an experienced trader and a portfolio manager, partner and Chief Investment Officer at Fenician Capital Management LLP, for market abuse, imposing a financial penalty of £100,000 and prohibiting him from performing any functions in relation to regulated activity.

The FCA considers that between 20 January and 15 May 2017, Mr Abbattista repeatedly placed in the market large misleading orders for Contract for Differences ('CFDs') which he did not intend to execute. At the same time, he placed smaller orders that he did intend to execute on the opposite side of the order book to the misleading orders.

Mr Abbattista has falsely represented to the market an intention to buy/sell, as well as that, his misleading orders were for volumes of shares far greater than the typical market size, which would also have created a false and misleading impression regarding the true supply of and demand for the shares in question to other market participants. The trading undertaken by Mr Abbattista was initially identified by the FCA's internal surveillance systems.

The FCA considers that the fine and the prohibition sought reflect the serious nature of the breach set out in the Decision Notice and should act as a deterrent to other market participants.



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USA - Ongoing Developments

SEC modernizes the accredited investor definition

The Securities and Exchange Commission ("**SEC**") has adopted amendments to modernize the definition of "accredited investor," one of the principal tests to determine whether an investor is eligible to participate in the U.S. private capital markets.

The amendments, which took effect on 26 August 2020, allow investors to qualify as accredited investors based on defined measures of professional knowledge, experience or certifications in addition to the existing tests for income or net worth, and expands the list of entities that may qualify as accredited investors.

Historically, individual investors could only meet the definition of accredited investor if they met a net worth or income threshold. The SEC's amendments for the first time allow an investor to meet the definition if they have a certain level of financial sophistication.

The amendments to the accredited investor definition include revising Rule 501(a) of the Securities Act of 1933, which:

- Adds a new category to permit natural persons to qualify as accredited investors based on certain professional certifications, designations or credentials – currently holders in good standing of the Series 7, Series 65, and Series 82 licenses – and allows the SEC to add certifications, designations, or credentials in the future;
- With respect to investments in a private fund, now includes natural persons who are "knowledgeable employees" of the fund;
- Clarifies that limited liability companies with $5 million in assets may be accredited investors and adds SEC- and state-registered investment advisers, exempt reporting advisers, and rural business investment companies ('RBICs') to the list of entities that may qualify;
- Adds a new category for any entity that own "investments," as defined in Rule 2a51-1(b) under the Investment Company Act, in excess of $5 million and that was not formed for the specific purpose of investing in the securities offered;
- Adds family offices with at least $5 million in assets under management and their "family clients"; and
- Adds the term "spousal equivalent" to expand the concept of spouse so that spousal equivalents may pool their finances for the purpose of qualifying as accredited investors.

The full SEC press release can be read here.

SEC proposes amendments to update Form 13F for institutional investment managers; reporting threshold amended to reflect today's equities markets

The SEC announced on 10 July 2020 that it has proposed to amend Form 13F to update the reporting threshold for institutional investment managers.

The initial threshold for filing the form was initially set at $100 million, an amount representing a certain proportionate market value of U.S. equities. The current proposal would raise the reporting threshold to $3.5 billion, reflecting proportionally the same market value of U.S. equities that $100 million represented in 1975, the time of the initial statutory directive.

The new threshold would retain disclosure of over 90% of the dollar value of the holdings data currently reported while eliminating the Form 13F filing requirement and its attendant costs for the nearly 90% of filers that are smaller managers.

The proposal will be published on the SEC's website and in the Federal Register, and there will be a 60-day comment period following publication in the Federal Register.

The full press release can be read here.

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USA - Regulatory News

CFTC Report on Climate Change

09/09/2020

On September 9, 2020, the Climate-Related Market Risk Subcommittee of the Market Risk Advisory Committee of the Commodity Futures Trading Commission ('CFTC') released a report entitled Managing Climate Risk in the U.S. Financial System.

The first of its kind from a U.S. government entity, the report makes clear the dangers of climate change and the risk it brings to the stability of the U.S. financial system. The extensive report sets out 53 recommendations and begins with one fundamental finding. In order for financial markets to efficiently channel resources to activities that reduce greenhouse gas emissions, the U.S. Congress must act and determine an economy-wide price on carbon. Once in place, policies can be implemented that incentivize the country to move towards a net-zero emissions economy.

The report also called for greater international cooperation and immediate action from U.S. federal agencies and regulators.

The CFTC requests comments on the proposed rule and makes specific requests for comments in the notice of proposed rulemaking. Comments are due to the CFTC by June 15, 2020.

that, subject to limited exceptions, neither the claimant nor any of its principals has in their background a CEA disqualification that would require disclosure, if the claimant sought registration with the CFTC.

The final rule is effective 60 days after publication in the Federal Register.

OCIE Risk Alert: Select COVID-19 compliance risks and considerations for investment advisers

12/8/2020

The Office of Compliance Inspections and Examinations ("**OCIE**") has identified a number of COVID-19-related issues, risks, and practices relevant to SEC-registered investment advisers. Additionally, market volatility related to COVID-19 may have increased the risks of misconduct in various areas which the staff believe warrant additional attention.

OCIE issued the Risk Alert to share some of these observations with firms, investors, and the public generally, and categorized them as follows:

- **Protection of investors' assets**

Every firm has a responsibility to ensure the safety of its investors' assets and to guard against theft, loss, and misappropriation. OCIE encourages firms to review and make any necessary changes to their policies and procedures around disbursements to investors, including where investors are taking unusual or unscheduled withdrawals from their accounts. Such steps may include implementing

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additional steps to validate the identity of the investor and the authenticity of disbursement instructions, including whether the person is authorized to make the request and bank account names and numbers are accurate.

- **Supervision of personnel**

Firms have an obligation to supervise their personnel, including providing oversight of supervised persons' investment and trading activities. OCIE encourages firms to closely review and modify their supervisory and compliance policies and procedures to reflect the current business activities and operations.

Firms may wish to modify procedures to address the following:

1. Supervisors not having the same level of oversight in a remote environment;
2. The impact of limited on-site due diligence reviews and other resource constraints associated with reviewing of third-party managers, investments, and portfolio holding companies; and
3. Communications or transactions occurring outside of the firms' systems due to personnel working from remote locations and using personal devices.

- **Practices relating to fees, expenses, and financial transactions**

Recent market volatility and the resulting impact on investor assets and the related fees collected by firms may have increased financial pressures on firms and their personnel to compensate for lost revenue. While these incentives and related risks always exist, the current situation may have increased the potential for misconduct regarding financial conflicts of interest and fees and expenses being charged to investors.

Firms should consider enhancing their compliance monitoring, including:

1. Validating the accuracy of disclosures and fee and expense calculations;
2. Identifying transactions that resulted in high fees and expenses to investors, and evaluating whether these transactions were in the best interest of investors; and
3. Evaluating the risks associated with borrowing or taking loans from investors, clients, and other parties that may create conflicts of interest.

- **Investment fraud**

The staff observed that times of crisis often bring a heightened risk of investment fraud in the form of fraudulent offerings. Firms should recognize these risks when conducting due diligence on investments and in determining whether or not the investments are in the best interest of investors.

- **Business continuity**

Considering the current environment of prolonged remote working for employees, firms should consider whether existing policies and procedures need to be modified to address unique risks and conflicts of interest. Other changes to operations may create additional risks which need to be addressed and mitigated.

OCIE encourages firms to review their continuity plans to address these matters, make changes to compliance policies and procedures, and provide disclosures to investors if their operations are materially impacted.

- **Protection of sensitive information**

OCIE staff has observed that many firms are requiring their employees to use videoconferencing and other electronic means to communicate while working remotely.

While these communication tools have allowed firms to maintain operations, they have created additional vulnerabilities around the loss of sensitive information.

OCIE recommends that firms pay particular attention to the risks regarding access to systems, investor data protection, and cybersecurity, including:

1. Enhancements to identity protection practices for any concerns about suspicious communications;
2. Providing employees with additional training to spotlight issues related to phishing and other targeted cyberattacks, sharing information while using remote and encrypting documents and using password-protected systems;
3. Conducting reviews of employee access rights and controls as individuals take on new or expanded roles in order to maintain business operations;
4. Ensuring that remote access servers are secured effectively;
5. Enhancing system access controls, including the use of multifactor authentication; and
6. Addressing new or additional cyber-related issues related to third parties which may also be operating remotely.

The full OCIE Risk Alert can be read here.

OCIE Risk Alert: Cybersecurity: ransomware alert

10/7/2020

The Office of Compliance Inspections and Examinations ("**OCIE**") released a Cybersecurity Risk Alert as it has observed an increase in the sophistication of ransomware attacks on SEC registrants, and also ransomware attacks impacting service providers to registrants. The Risk Alert describes OCIE's observations regarding practices employed by registrants to address these attacks, and is divided into six categories:

1. Incident response and resiliency policies, procedures and plans

Considering the current environment of prolonged remote working

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for employees, firms should consider whether existing policies and procedures need to be modified to address unique risks and conflicts of interest. Other changes to operations may create additional risks which need to be addressed and mitigated.

2. Operational resiliency

Registrants were observed determining which systems and processes are capable of being restored during a disruption so that business services can continue to be delivered, with a focus on applications considered critical to operations.

3. Awareness and training programs

Registrants provide specific cybersecurity training to all employees, including the undertaking of phishing exercises to help employees identify phishing emails and other potentially fraudulent electronic communications. Such training serves to provide employees with information concerning cyber risks and responsibilities and heightens awareness of cyber threats.

4. Vulnerability scanning and patch management

Registrants have been observed implementing proactive vulnerability and patch management programs that take into consideration current risks to the technology environment. Such programs are designed to ensure that all firmware, operating systems and application software, including anti-virus and other host-based security tools, have the most current updates.

5. Access management

Registrants have been observed managing user access through a variety of methods, including access limitation, separation of duties, re-certification of existing access, requiring strong and frequently changed passwords, using multi-factor authentication and the immediate revocation of system access for individuals who have departed the firm.

6. Perimeter security

Registrants Implemented perimeter security capabilities that are able to control, monitor, and inspect all incoming and outgoing network traffic to prevent unauthorized or harmful traffic. These capabilities include firewalls, intrusion detection systems, email security capabilities, and web proxy systems with content filtering.

OCIE encourages registrants, as well as other financial services market participants, to monitor the cybersecurity alerts published by the Department of Homeland Security Cybersecurity and Infrastructure Security Agency ('CISA'), including its updated alert published on June 30, 2020 relating to recent ransomware attacks. OCIE further encourages registrants to share this information with their third-party service providers, particularly with those that maintain client assets and records for registrants.

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Thank you for taking time to read our quarterly regulatory newsletter. Please contact us if you have any questions or feedback.

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