BRYAN CAVE LEIGHTON PAISNER | FINANCIAL REGULATION: EMERGING THEMES IN 2021

UK FOCUS

ASSET MANAGERS

Managing the most significant emerging regulatory risks in 2021

Building RESILIENCE

Today's speakers

Matthew Baker
Partner,
Financial Regulation

Adam Jamieson
Partner,
Financial Regulation

Nileena Premchand
Senior Associate,
Financial Regulation

Overview

- Introduction
- Brexit – an emerged theme?
- Culture and non-financial misconduct
- ESG – a marketing tool, or moving into the mainstream?

What you told us

- Operational resilience
- Brexit
- Conduct
- IFRPU/Prudential
- ESG
- LIBOR
- AML and financial crime
- Return to office
- AIFMD 2
- Sheer volume

Brexit

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Just when you thought it was over…

- This may just be the beginning
- Continues to emerge and evolve
- Detail awaited

Impact for services to the UK

- Temporary permissions regime
  - Next steps
  - Application of UK rules
- Overseas Funds Regime
  - Two new outcomes-based equivalence regimes
  - Approach for UCITS funds
- Overseas Framework
  - Treasury call to evidence
  - Attract activity to the UK and support financial stability

Impact for services to Europe

- Substance
  - Increased requirements
  - Impact on delegation
- Product and distribution
  - National private placement regime
  - Compliance with EU rules
- Reverse Solicitation

Culture and non-financial misconduct

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Culture change in itself is a challenge, and we know it takes time. This is because culture comes from the past and is embedded in the legacy of a business. The culture of a firm is developed and reinforced over years, even decades, and is passed down from one generation to the next.

As a result, culture can be remarkably resilient in the face of attempts to change it. However, if culture is ignored then an opportunity is lost to tackle one of the major root causes of conduct failures. The answer is not to try to tackle the culture, but to act on the many things that determine it...

Andrew Bailey,
Former Chief Executive of the FCA

The FCA’s 4 ‘drivers of culture’

- **Leadership -** including the tone that is set from the very top of the firm, and how effectively that tone cascades through the organisation.

- **People policies** - in particular the types of behaviour that are incentivised or disincentivised within the firm, and how this is done. This most obviously includes remuneration, but also extends to a far broader set of considerations including progression, promotion, recruitment, diversity and inclusion, speak-up culture and psychological safety.

- **Governance** - in the broadest sense of how decisions are made within a firm. This isn’t limited to the formal governance at the Board or most senior levels, but it is also focussed on the broader set of processes, systems, controls and arrangements by which decisions are made and business gets done. Firms with healthy cultures demonstrate strong governance that supports the daily delivery of their essential purpose.

- **Purpose** - how a company describes, to itself and others, the essential purpose of the firm, its products and its services, and so its reason for existing, and why the world would be worse off without the value it provides.

The FCA's focus on "non-financial misconduct" in light of the #metoo movement

Letter from Megan Butler (FCA Director) to the Chair of the Women and Equalities Committee (September 2018):

> A culture where sexual harassment is tolerated is not one which would encourage people to speak up and be heard, or to challenge decisions. Tolerance of this sort of misconduct would be a clear example of a driver of poor culture. It would be an obstacle to creating an environment where the best talent is retained, the best business choices are made and the best risk decisions are taken…
>
> Sexual harassment and other forms of non-financial misconduct can amount to a breach of our Conduct Rules, which include the requirement to act with integrity, and the SMCR imposes requirements on firms to notify us of Conduct Rule breaches.

Speech by Christopher Woolard (FCA Director, December 2018)

After my colleague Megan Butler spoke out on non-financial misconduct in May, we received our highest number of disclosures from whistleblowers. Not just involving issues around gender, but also racism, physical bullying and homophobia. In fact, over the last 12 months, we have seen a noticeable upturn in reports which concern issues like discrimination and sexual harassment in financial services. Our message to firms is clear: non-financial misconduct is misconduct, plain and simple.

Key points on non-financial misconduct

- The regulators take it very seriously. In their view, non-financial misconduct may amount to a breach of the individual Conduct Rules (Integrity), is relevant to a firm's assessment of fitness and propriety, and that firms tolerating it would be indicative of poor culture
- Issues such as sexual harassment, bullying and discrimination at work are now regulatory issues, and not just an HR/employment issues. HR, Compliance and Legal teams must work closely together to deal with it going forward. A consistent approach is required
- Regulatory notifications may be required when issues arise and such matters may need to be referred to on regulatory references
- SMF responsibility and engagement - SM&CR obligations
- We are regularly being asked to advise firms on how to manage these issues

ESG – moving into the mainstream

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ESG in context: European Commission's 2018 action plan on financing sustainable growth

Sets out strategy to connect finance with sustainability

Adopted in March 2018 (part of CMU package)

THE EUROPEAN COMMISSION ACTION PLAN

Opportunities for real estate:
propagating best practices, unlocking investment opportunities and being able to differentiate by adding value

Challenges for real estate:
systematic data collection and reporting, consistent measurement and reflecting nuances in real estate as an asset class

Key points for real estate fund investment:

- Establishing a taxonomy for sustainable activities
- Creating standards for 'green' financial products
- Incorporating sustainability as part of financial advice
- Developing sustainability benchmarks and better integrating sustainability into ratings
- Strengthening disclosures made by asset managers and financial advisers to their clients

ESG in context:
UK Green Finance ambitions

Green Finance Strategy (July 2019)

- Past commitments to match the EU in its level of ambition regarding sustainable finance
- Recent push to extend global leadership in green finance

Taskforce for Climate-related Financial Disclosures (TCFD)

- From 'comply or explain' to mandatory
- FCA to consult in H1 2021 on proposed disclosure rules for asset managers, life insurers and FCA-regulated pension providers
- Impact in 2022/2023

UK green taxonomy

- To be based on scientific metrics in the EU taxonomy

Key EU legislative initiatives for Asset Managers

1. **Disclosure Regulation** ((EU) 2019/2088)
   - also known as SFDR or the ESG Regulation
   - Applies from Mar 2021
   - Delay to final RTS publication and RTS compliance (likely end Jan 2022)

2. **Taxonomy Regulation** ((EU) 2020/852):
   - also known as the Framework Regulation
   - Applies from Jan 2022/2023
   - Draft Delegated Regulation (level 2) open for consultation

3. **AIFMD Level 2 Delegated Regulation** (amending Regulation (EU) 231/2013/EU)
   - Consultation closed in Jul 2020
   - Applies 12 months after coming into force (expected to apply Q3/Q4 2021)

4. **Voluntary ESG obligations and expectations** e.g. UN PRI, UN SDGs, Impact Management Project, PRI's report on fiduciary duties, other principles, frameworks, codes, practices

5. **Others:** Low Carbon Benchmarks Regulation, delegated legislation integrating sustainability relating to the UCITS Directive, Solvency II and the Insurance Distribution Directive plus local regulation (eg in the UK, the TCFD's Taskforce Roadmap)

6. **MIFID Delegated Directive** (amending Regulation (EU) 2017/593/EU)
   - Timings as per no 3

7. **MiFID II Organisation Regulation** (amending Regulation (EU) 2017/565/EU)
   - Timings as per no 3

ESG Regulation: key dates

10 December 2019: Benchmarks Regulation amended/came into force

29 December 2019: Disclosure Regulation came into force

23 April 2020: Disclosure Regulation: ESAs consult on level 2 measures (draft RTS)

30 April 2020: Benchmarks Regulation: administrator compliance (but ESMA no action letter)

8 June 2020: Disclosure Regulation: Delegated Acts published/open for consultation

12 July 2020: Taxonomy Regulation: came into force

October 2020: Disclosure Regulation: European Commission confirms delay to application of level 2 measures

[30 December 2020: Disclosure Regulation: deadline for 6 RTS to be finalised by the ESAs]

31 December 2020: Brexit transitional period ends

[31 January 2021: Disclosure Regulation: expected date for RTS to be finalised]

10 March 2021: Disclosure Regulation: principal rules apply (but note delay to RTS)

30 June 2021: Disclosure Regulation: mandatory compliance for 'large' financial market participants

Q3/Q4: Disclosure Regulation: MiFID II, UCITS, AIFMD, IDD and Solvency II amendments expected to apply

[31 December 2021: Disclosure Regulation: deadline for final RTS to be finalised]

31 December 2021: Benchmarks Regulation: new transparency obligations apply

1 January 2022: Disclosure Regulation: Annual reporting for Article 8 and Article 9 products

1 January 2022: Taxonomy Regulation: first set of technical screening criteria (for climate change mitigation or adaptation) apply

1 January 2022: Disclosure Regulation: expected deadline for RTS compliance

30 December 2022: Disclosure Regulation: adverse impact statements at product level

1 January 2023: Taxonomy Regulation: technical screening criteria (for other environmental objectives) apply

Dec 2019 | Jan 2020 | Jan 2021 | Jan 2022 | Jan 2023

What firms should be doing now

What firms should be doing now

Scoping exercise to map their obligations

- Greater disclosure and other requirements for firms that have a sustainability focus as part of their business. Also for firms categorised as 'large' (mandatory compliance)

Strategic approach

- This will impact the extent that a firm incorporates ESG into its services. Importance of an integrated approach with governance, policy and risk issues

Consider distribution chain and lifecycle

- AIFMD, MiFID II, Solvency II
- Asset level considerations

Practical approach

- Impact of delay of Disclosure Regulation Level 2 measures
- Brexit impact

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