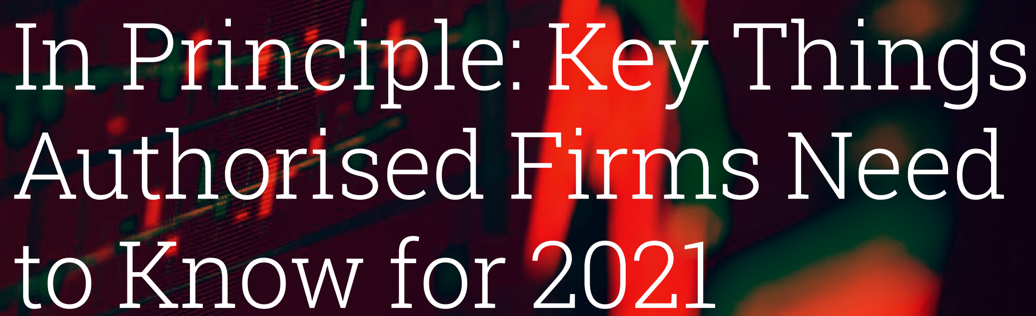

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Introduction

Welcome to the 2021 edition of In Principle. As with recent years, Brexit has been a significant feature to this year's legal developments, with the United Kingdom (U.K.) securing a post-Brexit trade deal with the European Union (EU) on December 24, 2020, just in time for the end of the Brexit Transition Period on December 31, 2020. The eleventh hour deal means that is also one which will undoubtedly feature heavily over the coming months, as most people – authorised firms included – navigate the post-Brexit landscape, which is still destined to change, with a further deal on financial services hoped for in the near future.

Whilst many anticipated the challenge posed by Brexit, few could have predicted the widespread effects of a global pandemic at the time of our last edition. COVID-19 has challenged even the largest businesses, turning the corporate environment on its head following the shift to remote working in March of last year. In the U.K., the Financial Conduct Authority (FCA) was also not immune to these challenges, shown in an early corresponding dip in new enforcement cases, as the regulator was forced to adapt quickly to these "unprecedented times" and the dreaded "new normal". At the same time, the FCA has been going through administrative changes, with fresh leadership and internal restructuring, indicating the potential ushering in of a reinvigorated regulatory approach.

As was the case last year, Environmental, Social and Governance issues remain high on the regulatory agenda, with the U.K. set to deviate from the main EU regimes – one example of a post-Brexit divergence. This notwithstanding, it is expected that the U.K. regime will share many features with the EU one, and the interconnectedness of the markets means that each regime will likely be relevant to firms in the other jurisdiction. A similar story can be told of the new prudential regimes for investment firms, where the EU and the U.K. are set to commence similar but distinct regimes – the EU's rules are set to come in during the middle of this year, and the U.K. regime six months later at the start of 2022.

In spite of the challenges presented by the pandemic, the FCA concluded a number of significant enforcement cases over the past year with repeated reminders to firms of the need to continue to comply with their compliance obligations in the remote working world. As firms remain faced with pandemic-related challenges, they must still hold space to turn their attention to other pressing issues that require preparation.

Executive Summary

1. Lifting the Lid on Brexit.

Along with many substantive changes to rules and regulations, Brexit has brought a new vocabulary and new sources of law. In order to understand what has happened, and what the new regime means, a basic fluency in this new language is required, from what it means for the U.K. to have "saved and incorporated" some EU laws into U.K. law, what are "Exit Regulations", and why are "equivalency decisions" more important than ever before? This article is a toolkit for understanding what Brexit has done and how to discuss what has happened.

2. The EU/U.K. Post-Brexit Agreement and Financial Services.

Whilst the Trade and Co-operation Agreement (TCA) which is now in force between the EU and the U.K. does not focus on financial services, it is not silent on the subject either. This article explains (i) what the TCA does and doesn't do in the financial services sector, and looks ahead to the anticipated further discussions on financial services co-operation to which both the EU and the U.K. have committed themselves.

3. Environmental, Social and Governance Issues.

As predicted in our 2020 edition, environmental, social and governance (ESG) matters have remained a key policy focus in the financial services sector. The EU has played a significant role in developing climate change policies, particularly with respect to the financial services industry, but there have also been a number of developments with respect to U.K. ESG policies. For those within scope of EU rules, the end

of the first quarter of 2021 will see a number of new requirements come into force, with additional U.K. climate related disclosures expected to apply from 2022. As such, firms within scope of these updated regulations will need to pay close attention to this new landscape that brings with it new obligations, including highly prescriptive disclosure requirements, as well as the increased attention that is anticipated from regulators and investors.

4. New U.K. Prudential Regime for Investment Firms.

Towards the end of 2020, the FCA began a consultation on new rules that would introduce the U.K. Investment Firm Prudential Regime (U.K. IFPR). The new regime is due to take effect shortly after the parallel EU Investment Firm Prudential Regime (EU IFPR) comes into force, but there are some differences between the two. With the U.K. changes expected to come into force from January 1, 2022, firms will need to dedicate time over the next 12 months to ensure that they are adequately prepared for the new rules and requirements.

5.Market Abuse.

2020 was a difficult year for firms in making sure they met their obligations around market abuse. With the shift to working from home, in particular, firms had to make sure that their remote monitoring policies and procedures were fully functioning in a way that had never been needed on such a scale before. Market abuse has been an FCA priority for some time, with such cases representing over 20 percent of open enforcement investigations at the end of March 2020. This article looks forward to some of the specific guidance which has emerged from the FCA over the past year.

6. Changing of the Guard at the FCA.

January 2021 represents a pivotal moment for the FCA. The continuing effects of the pandemic and post-Brexit landscape pose various challenges, but the regulator has also committed to an internal rejuvenation process, particularly in response to heavy criticism levied by two independent reviews that were published in December 2020. With fresh leadership in the form of the new Chief Executive Officer, Nikhil Rathi, the regulator seems poised to ring the changes, with a focus on diversity and inclusion and indications of a potentially more activist regulatory approach following its Business Interruption Insurance Test case which has just been decided by the U.K. Supreme Court. This article considers what the FCA's new apparent priorities and approaches will mean for regulated firms and individuals.

7. Enforcement Trends.

The 'elephant in the room' for analysing the FCA's recent enforcement trends is, of course, the pandemic. Given that it is relatively rare for a significant FCA enforcement action to commence and close within a year, we do not yet have a clear idea of how (or indeed whether) the FCA's approach to bringing enforcement cases has changed due to the pandemic. Prior to the pandemic, familiar signals were identifiable – the number of open cases, fines and quantum of penalties appeared to remain stable, with significant increases in case duration and costs. This article analyses the data available, and sets out what firms should take from this.

8. Key Cases and Enforcement Round-Up.

Whilst enforcement trends are hard to know at the moment, the FCA continued to close a number of significant actions during the course of 2020. These cases were diverse in subject matter, reflecting the regulator's wide ambit of jurisdiction. Discussed in this section are some of the most significant cases for regulated firms to be aware of.

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1. Lifting the Lid on Brexit

For some time now, legal advice has been given on the implications of Brexit. Advice has been needed on how to draft contractual terms to make sure that the documents will work through Brexit and what clients will have to do differently, practically speaking, because of Brexit. One common theme to this advice, however, is that it requires the use of a new vocabulary and a new understanding of sources of law. When the Brexit Transition Period ended at 11 p.m. on December 31, 2020, some fluency in this new language became essential to understand the implications of Brexit on contractual and operational matters relevant to investment managers.

This article is intended to provide a toolkit of background knowledge and necessary vocabulary to understand the new framework which is now in force. To the uninitiated – and indeed, sometimes, to the initiated – some of these provisions appear overly intricate, but understanding the context and how law in the U.K. is changing does make things clearer.

This article starts with a brief background to explain the legislative background to Brexit: how did EU law apply in the U.K., through to the end of the Transition Period. It then explains how EU law has been saved and incorporated into U.K. domestic law, including describing how amendments have been made in the "saving and incorporation" process through Exit Regulations. This note then explains what equivalence decisions are and how these can assist firms. Next, this article discusses briefly how the FCA's Temporary Permissions Regime functions.

The following article in this publication then explains the agreement that was reached between the U.K. and the EU at the very end of 2020, and how this agreement will affect financial services firms.

EU law in the U.K. to December 31, 2020

European Communities Act 1972

Under the U.K. Constitution, Parliament is sovereign: in colloquial terms, what Parliament says, goes. This can include delegating or reassigning legislative power, only subject to the requirement that what Parliament gives, Parliament can also take away.

Under European Communities Act 1972 ("ECA 1972"), EU legislation became supreme in the U.K., EU regulations started to have direct effect and U.K. ministers were delegated the power under section 2(2) to issue such secondary legislation as was necessary to implement EU directives.

Since that time, the EU's competence continued to grow, and within its member states EU legislation now governs whole swathes of law, from trade marks to fisheries and financial services.

Brexit Referendum, Leaving the EU and the Transition Period

On June 23, 2016, the U.K. held a referendum on membership in the EU. A majority of the electorate voted to leave the U.K. On March 29, 2017, the then Prime Minister, Theresa May, triggered Article 50 of the Treaty on European Union, and the countdown to the U.K.'s leaving the EU commenced.

In January 2020, the U.K. and the EU agreed on a Withdrawal Agreement. Consistent with the terms of that Agreement, the U.K. ceased to be an EU member state at 11 p.m. on January 31, 2020 ("Exit Day"), and entered into a Transition Period. At that point, pursuant to section 1 of the European Union (Withdrawal) Act 2018 ("EUWA 2018") the ECA 1972 was repealed.

Under the Withdrawal Agreement, it had been agreed that for the duration of the Transition Period the U.K. would continue to act as if it were, and it would be deemed to be, a member state of the EU for most purposes. In order to implement this legislatively, sections 1A and 1B of EUWA 2018 were inserted by sections 1 and 2 of the European Union (Withdrawal Agreement) Act 2020 ("EUWAA 2020"), under which ECA 1972 and secondary legislation created under it were deemed to continue to have effect as it had done before (notwithstanding its formal repeal).

As a result, unless one was looking very closely, the law in the U.K. on February 1, 2020 looked very much like it did the day before.

The Transition Period ended at 11 p.m. on December 31, 2020. Under the Withdrawal Agreement, there was a mechanism for the U.K. and the EU to agree on an extension to the Transition Period. As a matter of English law, however, the U.K. Parliament included a provision in EUWAA 2020 to prohibit the Government from acceding to any such extension, and consequently no extension was agreed upon.

In U.K. legislation, 11 p.m. on December 31, 2020 – i.e. the end of the Transition Period – is known as Implementation Period completion day or "IP completion day".

End of the Transition Period

As stated above, EU law occupies many fields of legislation and if nothing had been done, upon the repeal of the ECA 1972, these areas of law would have been devoid of modern legislation in the U.K., with a potentially highly destabilising effect.

To allow for an orderly legal transition, the U.K. has saved and incorporated EU legislation into U.K. legislation, albeit with some amendments to change references to EU rules, bodies or institutions to the corresponding relevant U.K. references.

Saving and Incorporation

Different writers have used different terminology for how EU law became U.K. law at IP completion day, with some calling it "onshoring", "domestication" or "transposition". Whilst these words broadly capture what happened, it can be helpful to return to using the language of the statutes themselves, namely "saving" and "incorporation". Using these terms can be particularly helpful because they apply to two different and distinct types of law: "EU-derived domestic legislation" and "direct EU legislation".

For completeness, as well as EU-derived domestic legislation and direct EU legislation, there is a third type of "retained EU law", namely:[1]

> "Any rights, powers, liabilities, obligations, restrictions, remedies and procedures which, immediately before IP completion day (a) are recognised and available in domestic law … and (b) are enforced, allowed and followed accordingly, continue on and after IP completion day to be recognised and available in domestic law (and to be enforced, allowed and followed accordingly)."

Consequently, rights which arose under EU law prior to IP completion day continue to be enforceable thereafter.

EU-derived Domestic Legislation

EU directives are directed towards the member states, and each member state is required to implement the directive into its own domestic law. In the financial services sector, relevant directives include the recast Markets in Financial Instruments Directive (MiFID II), the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings for the Collective Investment in Transferable Securities Directive (UCITS Directive). In general, directives do not have "direct effect" in member states, but only have legal consequences through the domestic implementing legislation.

As mentioned above, the U.K.'s usual mechanism for implementing EU directives was for a minister to enact a statutory instrument relying on section 2(2) of the ECA 1972. These statutory instruments fall within the definition of "EU-derived domestic legislation" in EUWA 2018.

Whilst acting through statutory instruments has been the usual way in which directives are implemented, in some circumstances provisions of EU law were also implemented by inserting provisions into primary legislation. An example of this is that the U.K. domestic criminal regime prohibiting market abuse in Part V of the Criminal Justice Act 1993. This regime provides a special defence that a crime is not committed if the defendant acted in accordance with the EU Market Abuse Regulation (EU MAR). As this provision was inserted through a statutory instrument issued under section 2(2) of the ECA 1972, such provision constitutes "EU-derived domestic legislation" even though it appears on its face to be primary legislation.

Under section 2(1) of EUWA 2018:

> "EU-derived domestic legislation, as it has effect in domestic law immediately before IP completion day, continues to have effect in domestic law on and after IP completion day."

Consequently, statutory instruments in effect at IP

1 Section 4 of EUWA 2018.

completion day continue to have the same effect after IP completion day, notwithstanding that the authority for their promulgation under section 2 of the ECA 1972 has fallen away. In this way, EU-derived domestic legislation has been "saved".

It should be noted, by contrast, that EU directives themselves (as compared to the instruments implementing the directives) have not been "saved" or otherwise incorporated into U.K. law. For example, there is no "U.K. MiFID" separate from those provisions of U.K. law which implemented MiFID prior to IP completion day. There are several consequences of this, for instance, and continuing to use MiFID as an example, because the definition of "investment firm" in the EU texts only appears in the EU directive, in order to make sure that it still continues to have effect in U.K. law it was necessary for it to be inserted under Exit Regulations (see below) into the U.K. law – in this case, it was inserted as Article 2(1A) into the U.K. version of the Markets in Financial Instruments Regulation (U.K. MiFIR).[2]

Whilst the "saving" of EU-derived domestic legislation is comparatively easy to state – taking just one subparagraph in section 2 EUWA 2018 – there are a lot of outstanding questions and problems inherent in the saving process. Perhaps the most significant issue is that whilst section 2 EUWA 2018 purports to maintain the "effect" of legislation, (i) this is subject to any changes made by Exit Regulations (see below) and (ii) the way in which courts construe such legislation is set to change.[3] Whilst, then, at a high level there is continuity, to understand the detail of "saved" legislation will require careful scrutiny.

It should also be noted that if the U.K. has not implemented a particular EU Directive by December 31, 2020, (whether because it has not been required to do so, or has simply failed to do so), the U.K. will not be under any obligation to implement it from that point on.[4] This is because only legislation "as it has effect" in domestic law will be saved under section 2(1) EUWA 2018.

Direct EU Legislation

Under the ECA 1972, EU Regulations, Delegated Regulations and Implementing Regulations had "direct effect" in the U.K., as in all other member states. For the financial services sector, this includes: EU MAR, the European Markets Infrastructure Regulation (EU EMIR), the Short Selling Regulation (EU SSR), the EU Prospectus Regulation, the Markets in Financial Infrastructure Regulation (EU MiFIR), the General Data Protection Regulation (EU GDPR), and various pieces of secondary legislation made under them. These laws had effect in the U.K. without needing any domestic implementation, although in some areas domestic law or guidance (including FCA rules and guidance) was made to supplement them. These supplemental provisions of domestic law will continue to be in effect, unless otherwise changed in the ordinary course.

These laws with "direct effect" are termed "direct EU legislation", and under section 3(1) of EUWA 2018, these laws have been "incorporated" into U.K. domestic legislation "insofar as operative immediately before IP completion day".[5]

Consequently, Regulations such as EU MAR, EU MiFIR and EU SSR, which were "operative" as at December 31, 2020, have been incorporated into U.K. law, and U.K. versions of the law – "U.K. MAR", "U.K. MiFIR" and "U.K. SSR" – each commenced at IP completion day. Similarly, delegated legislation such as the EU MiFID Org Regulation and the EU MAR Delegated Regulation detailing market sounding requirements were also incorporated into U.K. law.[6] These U.K.

2 Regulation (EU) 600/2014.

3 There is a principle of EU law that, insofar as possible, statutory instruments implementing an EU directive must be construed in a manner which is consistent with, and which furthers the aims of, the underlying EU directive.
Section 5(2) of EUWA 2018 appears to retain this general canon of construction, notwithstanding that EU directives themselves will not become part of U.K. law. As such, previous judgments from the Court of Justice of the European Union (CJEU) interpreting EU directives will continue to guide the interpretation of U.K. statutory instruments.
However, under section 6 of EUWA 2018, and under the (unwieldingly named) draft European Union (Withdrawal) Act 2018 (Relevant Court) (Retained EU Case Law) Regulations 2020, the U.K. Supreme Court, the relevant courts of appeal in England and Wales, Scotland and Northern Ireland, and certain other named courts, will be free to disregard judgments of the Court of Justice of the European Union.
As such, there is a very complicated situation whereby the courts of first instance are bound to interpret U.K. statutory instruments implementing EU directives in line with judgments of the CJEU, but on appeal, a court could come to a quite different interpretation using distinct canons of construction and interpretation.
It is hoped that the appellate courts will use their power to deviate from CJEU judgments sparingly.

4 In particular, under Schedule 1 of EUWA 2018, no damages will be available under the cause of action recognised by the CJEU in *Francovich v. Italy* C-6/90 (1991).

5 It should be noted that, occasionally, an EU Directive can be held to have direct effect in the member states. This is a relatively rare occurrence, particularly in the financial services sector. In such circumstances, however, it appears that such provisions continue to form part of U.K. law through section 4 of EUWA 2018.

6 As a technical matter, a distinction is drawn in the U.K. legislation between "direct principal EU legislation" (Regulations themselves) and "direct minor EU legislation" (e.g. Delegated Regulations), although the distinction drawn is essentially procedural.

laws are 'parallel' to their EU equivalents, albeit with amendments made through Exit Regulations (see below) and also potentially subject to divergent interpretation by the U.K. courts.[7]

Some care has to be taken with respect to EU laws which had been enacted but had not yet taken effect at IP completion day. Determining whether or not these are "operative" – as defined in section 3(3) of EUWA 2018 – is an unhelpfully subtle exercise:

- If a provision of law states, "The placing on the market of products and equipment listed in Annex III … shall be prohibited from the date specified in that Annex",[8] this provision is deemed to have been "operative" at IP completion day, even if some of the dates in the Annex are after IP completion day.[9] Consequently, this provision has been incorporated into U.K. law.
- By contrast, if a law states, "This Regulation shall apply from 10 March 2021",[10] this law is not deemed to have been "operative" at IP completion day, and was not be incorporated into U.K. law.

In the financial services sector, most "prospective" EU legislation is of the second kind, not the first, and therefore it can generally be assumed that forward-looking legislation has not been incorporated into U.K. law from IP completion day. This type of legislation which has not been incorporated includes the Taxonomy Regulation and the Sustainable Finance Disclosure Regulation.

We note further that where current EU legislation contains provisions which are due to take effect from some future date, the U.K. Government has often legislated to clarify the position through Exit Regulations: see below.

Exit Regulations

As explained above, under EUWA 2018, EU-derived domestic legislation was saved in, and direct EU legislation was incorporated into, U.K. law on IP completion day. Had this saving/incorporation only meant "copying out" the EU text onto the U.K. statute book, this could have led to some illogical results. A common example is that EU law is replete with references to EU-specific institutions (such as the EU Commission or the European Securities and Markets Authority (ESMA)) which have now ceased to have jurisdiction in the U.K. after IP completion day: it would make no sense for such provisions to be part of the U.K.'s domestic law in these circumstances.

In recognition that mere copying out would lead to unintended results, section 8 of EUWA 2018 gave Government ministers the power to issue "Exit Regulations" to "prevent, remedy or mitigate" any "failure of retained EU law to operate effectively" or "any other deficiency in retained EU law". As set out above, because "EU derived domestic legislation" can include amendments to provisions of primary legislation, Exit Regulations can amend primary legislation as well.[11]

It should be noted that the definition of "deficiency" in section 8 of EUWA 2018 is broad, and the power of U.K. Ministers to issue Exit Regulations to "correct" deficiencies is correspondently so.[12] Consequently, whilst some "corrections" which have been made are truly minor, for instance transferring authority from ESMA to the FCA, in other circumstances the "corrections" are much more significant, including, for example, the revocation of provisions of the Sustainable Finance Disclosure Regulation to make sure that none of that Regulation has force in the U.K.

Hundreds of sets of Exit Regulations have already been passed.[13] Unfortunately, it is the nature of the various moving targets involved that sometimes multiple different Exit Regulations need to be considered in relation to the same law, and so pinning down exactly what the text of each particular law says can be a very time-consuming and complex exercise.[14] While legal resources such as legislation.gov.uk have been working

7 We note that only the English language version of EU legislation is incorporated into U.K. law. Under section 3(4) of EUWA 2018, however, the other language versions of EU legislation may still be used to aid interpretation of the retained law

8 See Regulation 517/2014, Article 11(1).

9 See paragraph 88 of the EUWA 2018 Explanatory Notes.

10 See Regulation 2019/2088.

11 Particularly to a United States audience, it may seem extraordinary that the executive should be given the power to amend legislation. In U.K. law however, the use of so-called "Henry VIII-clauses" is rare, but not unheard of.

12 It is somewhat likely that parties will seek to contest the legitimacy of some of the Exit Regulations in due course on the basis that particular Exit Regulations go beyond the power to correct "deficiencies". Given the breadth of the definition, however, it seems sensible to start with the presumption that the Exit Regulations would be held valid in most circumstances.

13 It should be noted that some of the Exit Regulations which were drafted prior to January 2020 still say that they will come into force on "Exit Day". Unhelpfully, this language has not formally been amended, but rather under paragraph 1 of Schedule 5 to the EUWAA 2020, such references are "to be read" as referring to IP completion day.

14 For example, to determine the text of U.K. MAR requires consideration of The Financial Services (Electronic Money, Payment Services and Miscellaneous Amendments) (EU Exit) Regulations 2019 (here), the Gibraltar (Miscellaneous Amendments) (EU Exit) Regulations 2019 (here), The Market Abuse (Amendment) (EU Exit) Regulations 2019 (here) and The Public Record, Disclosure of Information and Co-operation (Financial Services) (Amendment) (EU Exit) Regulations 2019 (here).

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make "consolidated" acts publicly available, these cannot infallibly be relied on to constitute a complete and up-to-date statement of the law.

Equivalence Decisions

In certain provisions of EU law, the EU Commission is given the power to issue an "equivalence decision" (or, in some contexts, an "adequacy decision"). In such circumstances, a third country (i.e., not an EU member state) can be treated as if it were a member state for a specified purpose. Equivalence decisions are limited in scope – even if every equivalence determination available is issued, there is not open access to the EU or U.K. market – but they do mitigate some of the challenges working across borders can bring.

When the U.K. saved and incorporated EU law, it also saved and incorporated those parts of EU law which allowed for equivalence decisions to be made. As such, not only does the EU have the power to issue (or decline to issue) equivalence decisions for the U.K. to be treated as an equivalent third country for a specific purpose under a statute (say, EMIR), the U.K. also has the power to issue its own equivalence decisions (including for the EU to be treated as an equivalent third country) under the U.K. version of EMIR.

Equivalence decisions are important in the financial services sector: to continue using EMIR as an example, parties to certain derivatives have to exchange collateral, unless an exemption applies. One set of exemptions applies to entities which are in the same group, and these exemptions only apply when either both parties are in the EU, or where one party is in the EU and the other is in a third country for which a suitable equivalence determination has been made. The exemption does not apply, however, if the third country does not benefit from an equivalence decision.

Where the ability to make an equivalence decision is contemplated in legislation, the determination whether or not each equivalence decision will be issued is within the political gift of the relevant executive authority. There is no mechanism of judicial review, and equivalence decisions cannot be claimed as of right.

As decisions of the EU Commission, equivalence decisions which have been issued by the EU constitute retained EU law in the U.K. after IP completion day, unless and until they are otherwise revoked. The U.K. Government has confirmed this in a specific Guidance Document on the U.K.'s Equivalence Framework.[15]

15 https://www.gov.uk/government/publications/guidance-document-for-the-uks-equivalence-framework-for-financial-services.

Whilst the continuation of these equivalence decisions with third countries (such as certain equivalence decisions with the United States or Japan) is to be welcomed, there are one set of equivalence decisions which this incorporation of direct EU legislation does not assist with: namely, will the EU issue equivalence decisions with respect to the U.K., and vice versa?

Whilst the U.K. has been particularly forward in issuing unilateral equivalence decisions in favour of the EU, in substantial part the answer to this question remains in substantial part, "wait and see". For a more detailed discussion of the specific provisions, please see the following article in this publication.

Temporary Permissions Regime

It is a criminal offence in the U.K. to provide financial services by way of business without authorisation from the FCA. Most firms acting in the U.K. receive authorisation under Part 4A of the Financial Services and Markets Act 2000. Some non-U.K. firms from EU member states, however, provide services in the U.K. under a financial services passport.

After IP completion day, firms will no longer be able to rely on an EU financial services passport. Ultimately, all financial services firms providing services in the U.K. will need a Part 4A permission. The process of applying for authorisation, however, is time consuming and an administrative burden. To make sure that there is no "cliff-edge" where a firm is permitted to provide services on December 31, 2020 but not on January 1, 2021, the FCA has implemented the Temporary Permissions Regime (TPR). Firms which have notified the FCA of their intention to rely on the TPR will be permitted to continue to provide services, until the FCA informs them that they need to make an application, and then that application is determined.

Whilst the FCA has generally designed the TPR to permit firms to continue to act as they do now, providing that they comply with their Home State regulator's requirements, a firm relying on the TPR will have to comply with some additional FCA rules. Which rules will depend on what type of firm is relying on the TPR, and what activities are being performed. Ultimately, once a firm becomes fully authorised by the FCA, that firm will have to comply with the full suite of relevant FCA rules, which can be more extensive than those imposed by their Home State regulator.

Conclusion

As stated at the beginning, this article is intended to be an introduction to the new legislative framework within which financial services firms will have to work in the U.K. after Brexit. Having a working knowledge of this vocabulary will undoubtedly make the transition for firms easier.

The next article in this publication, "The EU/U.K. Post-Brexit Agreement and Financial Services", discusses the post-Brexit agreement which has now been reached between the EU and the U.K.

2. The EU/U.K. Post-Brexit Agreement and Financial Services

Introduction

On December 24, 2020, the EU Commission and the U.K. Government reached an agreement – in fact, a series of agreements and declarations – on the post-Transition Period relationship (the "Agreement").

On December 30, 2020, the U.K. Parliament voted to ratify the Agreement and to enact certain legislation necessary for its implementation, and the European Union (Future Relationship) Act 2020 ("EUFRA 2020") received Royal Assent and became law soon thereafter. As well as specific provisions implementing parts of the Agreement, EUFRA 2020 grants powers to Ministers to issue secondary legislation to implement the Agreement, and includes section 29(1), which provides a catch-all provision stating that "[e]xisting domestic law has effect on and after [the Agreement comes into force (whether provisionally or otherwise)] with such modifications as are required for the purposes of implementing" the Agreement in U.K. law.

On the EU's side, full ratification of the Agreement requires a vote of the European Union Parliament, and logistically it was not possible for such vote to be held prior to the end of the Transition Period. Under the terms of Article 218 of the Treaty on the Functioning of the European Union, however, the EU Council (heads of state or government from each of the 27 EU member states) was able to adopt decisions authorising the signing of the Agreement, and at the same time to provide that the Agreement would apply provisionally from the end of the Transition Period, pending full ratification.[16]

As such, the Agreement is now in force.

The TCA – General Provisions

As stated above, the Agreement is in fact in multiple parts. The principal part is the Trade and Cooperation Agreement (TCA). The "trade" portion of the TCA deals primarily with the trade in goods, rather than services, and the "cooperation" agreement has provisions regarding law enforcement and judicial cooperation, security, mutual assistance in customs matters, social security coordination, as well as the U.K.'s participation in certain specific EU programmes. The TCA also contains functional provisions dealing with dispute settlement and remedies in case of breach.

As the operative provisions regarding trade are focused on the trade in goods, it is perhaps unsurprising that much of the TCA will not be directly relevant to financial services firms. There is, however, a very short section in Part Two, Title III, Chapter 3, Section 5, entitled "Financial Services", which includes a commitment by both the EU and the U.K. will seek to ensure that international standards are upheld, including those of the G20, the Basel Committee on Banking Supervision and the Financial Action Task Force. The EU and the U.K. have also agreed to

16 https://www.consilium.europa.eu/en/press/press-releases/2020/12/30/press-release-signature-of-the-eu-uk-agreement-30-december-2020/. See also Article 218(5) of the Treaty on the Functioning of the European Union states in full, "The Council, on a proposal by the negotiator, shall adopt a decision authorising the signing of the agreement and, if necessary, its provisional application before entry into force.

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grant financial services firms established in the other jurisdiction access to payment and clearing systems.

Beyond the fairly short section specifically on financial services, there are certain other provisions which may be pertinent to consider in specific circumstances, including for example:

- Part 2, Title II, which is concerned with allowing EU/U.K. cross-border investments.
- Part 2, Title IV, which deals with the free movement of capital and payments in relation to transactions covered by the Agreement.
- Part 2, Title V, on intellectual property.
- Part 2, Title X, on anti-money laundering and counter terrorist financing.

The TCA – Data Protection and Adequacy Determinations

A further set of provisions in the TCA which will be relevant to financial services firms are those dealing with data protection. In the absence of adequacy decisions, the EU and the U.K. would have each treated the other jurisdiction as a "third country" for the purposes of their respective data protection legislation, and as such the cross-border sending of personal data would have been heavily restricted.

As long ago as 2019, however, the U.K. had already made a legislative determination of "adequacy" with respect to the EEA member states – i.e., the EU, Iceland, Liechtenstein and Norway.[17] Now, under the TCA, the EU has also agreed that the transfer of personal data to the U.K. will not be considered a transfer to a third country for a period of up to four months,[18] or until the EU issues an adequacy decision (whichever is the sooner).[19] It is also contemplated that Iceland, Liechtenstein and Norway will also agree that the U.K. will not be treated as a third country for the same period, pending their own adequacy determinations being made.[20]

As such, personal data will be able to be transferred between the EEA member states and the U.K. under the same rules as currently apply at least for the next four months, in which time the EU and other EEA member states are expected to pass adequacy decisions guaranteeing that these rules will continue longer term.

17 Schedule 2 to the Data Protection, Privacy and Electronic Communications (Amendments etc) (EU Exit) Regulations 2019, https://www.legislation.gov.uk/uksi/2019/419/schedule/2, inserted Schedule 21 to the U.K. Data Protection Act 2018, Paragraphs 4 and 5 of which provided an adequacy determination for the EEA member states and institutions, as well as all other member states which already benefited from an EU adequacy determination.

18 Which may be extended to six months.

19 Article FINPROV.10A (1) and (4).

20 Article FINPROV.10A (2).

The Declarations and Equivalence Decisions

As noted above, the TCA is only one part of the Agreement reached between the EU and the U.K. Another part of the Agreement are a series of 15 Declarations,[21] the first of which is entitled "Joint Declaration on Financial Services Regulatory Cooperation Between the European Union and the United Kingdom". It consists of two paragraphs, which are worth setting out in full:

- "The Union and the United Kingdom agree to establish structured regulatory cooperation on financial services, with the aim of establishing a durable and stable relationship between autonomous jurisdictions. Based on a shared commitment to preserve financial stability, market integrity, and the protection of investors and consumers, these arrangements will allow for:
    - bilateral exchanges of views and analysis relating to regulatory initiatives and other issues of interest;
    - transparency and appropriate dialogue in the process of adoption, suspension and withdrawal of equivalence decisions; and
    - enhanced cooperation and coordination including in international bodies as appropriate.
- Both [the EU and the U.K.] will, by March 2021, agree a Memorandum of Understanding establishing the framework for this cooperation. The Parties will discuss, inter alia, how to move forward on both sides with equivalence determinations between the [European] Union and the United Kingdom, without prejudice to the unilateral and autonomous decision-making process of each side."

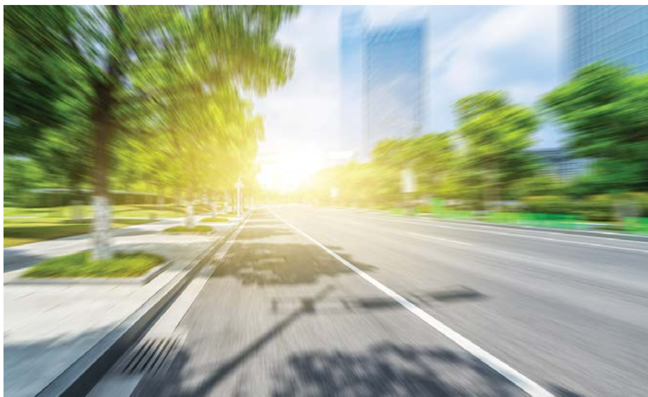
Whilst somewhat devoid of detail, there are two points which are worth noting at this stage: first, March 2021 is when we can expect further detail, and it is unlikely that there will be any further concrete decisions before then – and, even then, it is not clear that there will be anything 'concrete', but rather a clearer roadmap ahead. Second, and more importantly, it does appear that equivalence decisions are going to be the *modus operandi* at least in the medium term, thwarting any hope that there might be some fuller trade deal relating to services.

21 https://ec.europa.eu/info/sites/info/files/draft_eu-uk_declarations.pdf.

As explained in the previous article in this publication, equivalence determinations are an important feature of both EU and (now saved and incorporated) U.K. regulatory law. Whilst equivalence decisions cannot provide the type of market access previously enjoyed when the U.K. was an EU member state, they can ease some of the regulatory barriers.

Whilst we are waiting until March 2021 to find out more, however, the U.K. has already taken some substantial steps to grant the EU certain equivalence decisions. It is perhaps surprising that these decisions were taken unilaterally, even before the Agreement was made. These unilateral equivalence decisions include the full suite of available determinations in relation to the Capital Requirements Regulation, EMIR, the Benchmarks Regulation and the SSR amongst others. Whilst these are not all the possible equivalence decisions – i.e., there are some further equivalence decisions which the U.K. Government could issue with respect to the EU – this is certain a distinctly positive step for participants, and it can only be hoped that the EU will decide it is in its best interests to reciprocate in due course.

3. Environmental, Social and Governance Matters



High-level Summary

Environmental, social and governance (ESG) matters have emerged as a key policy focus in the financial services sector. The EU has adopted ambitious plans in relation to climate change and sustainability, and different national requirements applicable to certain types of institutional investors have been enacted in a number of EU member states. The U.K. has proposals for its own domestic rules in response to its international commitments, partly as a matter of domestic priority. Investment managers will need to pay close attention to this new landscape that will bring new obligations, including disclosure requirements, and greater scrutiny both from regulators and investors.

New EU and U.K. ESG Rules

The new suite of EU rules requiring disclosures by investment management and investment advisory firms regarding an assessment of the impact of their activities on ESG considerations will start to apply from as early as March 10, 2021. Firms should conduct impact assessments to determine what changes may be required to their systems and processes, policies and product documentation.

Whilst the new EU rules are of greater relevance to firms with an ESG or sustainability focus, components of the rules will apply to all firms, including those with no ESG or sustainability focus and will require policy decisions that will determine the extent of the firm's disclosure obligations.

As described further below, new climate-related disclosures will apply to investment managers in the United Kingdom under a U.K. disclosures regime that is expected to be phased in from 2022.

We summarise below the key provisions of the EU's Sustainable Finance Disclosure Regulation (SFDR); the EU's Taxonomy Regulation; and the U.K. mandatory climate-related disclosures regime proposed for (among others) investment managers – to be based on the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD).

Although the finer details implementing the new frameworks have not yet been finalised, or in the case of the U.K., have not yet been published, it is clear that the EU and the U.K. have ambitious plans for enhancing ESG disclosure in the financial services sector.

Further, we have outlined the proposed amendments to the recast MiFID, AIFMD and UCITS Directive,

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which integrates sustainability considerations to firms' systems and processes, as well as the proposed amendments to MiFID embedding ESG considerations and preferences as part of suitability assessments performed by MiFID investment firms in the context of portfolio management and investment advisory services – all which are expected to apply from the second half of 2021.

Which Firms are In-Scope of the New ESG Rules?

EU Rules

The EU SFDR and the EU Taxonomy Regulation apply to "financial market participants", including (among others) MiFID investment firms in respect of the portfolios that they manage i.e., managed or segregated account services; Alternative Investment Fund Managers (AIFMs) in respect of their management of Alternative Investment Funds; and UCITS management companies in respect of their management of UCITS investment funds.

A sub-set of rules under the EU SFDR apply to "financial advisers", including investment advisory services provided by MiFID investment firms and AIFMs and UCITS management companies pursuant to their "top-up" permissions.

U.K. Rules

On November 9, 2020, the U.K. task force chaired by HM Treasury and several U.K. regulators, including the FCA, (the "Taskforce") published the Interim Report of the U.K.'s Joint Government-Regulator TCFD Taskforce (the "Interim Report") together with a high-level road map outlining how the Taskforce intends to achieve the recommendations of the Interim Report.

The Interim Report concluded that the U.K. should move toward mandatory TCFD-aligned disclosures across several sectors of the economy and envisaged regulatory or legislative measures across seven "categories of organisations" including asset managers, such as U.K. authorised MiFID investment firms performing portfolio management services, AIFMs, UCITS management companies and self-managed UCITS investment funds (i.e., which do not have an external management company).

The subtext for the Taskforce's proposals for a move toward a mandatory disclosure regime appears to be driven in large part by the perceived lack of adequate progress by organisations with respect to the adoption of the TCFD's recommendations, as well as a desire for the U.K. to be seen to be a leading jurisdiction with regard to future proofing its economy to "meet tomorrow's challenges" from the threats posed by climate change.[22]

When do the New ESG Disclosure Rules Apply?

EU Rules

The EU SFDR will apply in the EU in phases from March 10, 2021, and the EU Taxonomy Regulation will apply in the EU in phases from January 1, 2022. Please see Annex 2, which sets out the applicable commencement dates of the specific requirements in more detail.[23]

The European Commission has postponed to a "later stage" the deadline for the drafting of secondary legislation implementing the SFDR disclosure requirements. However, despite this delay, the Commission stated that there will be no regulatory forbearance for market participants in relation to complying with the EU SFDR's general principles of sustainability-related disclosures in three specific areas, as these requirements are not "conditional on the formal adoption and entry into force or application" of the secondary legislation.[24]

The three main disclosure requirements specified by the European Commission are the:

- Disclosures related to the integration of sustainability risks in the investment decision-making process.
- Pre-contractual disclosure requirements applicable in the case of financial products that are promoted as having an ESG-focus or that have ESG as an investment objective.
- Disclosures related to whether the investment manager (or the financial product) considers the principal adverse impacts of investment decisions on sustainability.

The European Commission also made an important clarification about its expectations of market participants (including investment managers) under the current regulatory frameworks (which includes the recast MiFID, AIFMD and the UCITS Directive), stating that market participants are already required to

22 Interim Report of the UK's Joint Government-Regulator TCFD Taskforce, November 2020 (here).

23 https://www.akingump.com/a/web/e3C7pVoG7WCFK6MsyBGXrC/239D1w/annex-2-the-sfdr-and-taxonomy-regulation.pdf.

24 Application of Regulation (EU) 2019/2088 on the sustainability-related disclosures in the financial services sector, October 20, 2020 (here).

integrate sustainability into their investment decision-making processes and that product manufacturers (such as investment managers) are already expected to disclose information to investors on how the level of sustainability of an ESG-focused product is achieved.

U.K. Rules

In the U.K., the climate-related disclosure rules developed in accordance with the Interim Report are expected to apply in the U.K. from 2022 for the largest investment managers (those with assets under management in excess of £50 billion) and from 2023 for other investment managers. The FCA is currently developing detailed policy proposals with a view to publishing a consultation paper in the first half of 2021.

What are the New ESG Disclosure Rules?

EU Rules

The EU SFDR imposes transparency and disclosure obligations on investment managers, including in relation to their policies on sustainability and remuneration, marketing communications, pre-contractual disclosures and periodic reporting to investors. The requirements are set out in more detail in Annex 2.[25]

The EU SFDR imposes requirements on all investment managers, irrespective of whether the manager manages or markets funds or portfolios with an ESG-focus. The requirements include disclosures by the investment manager on:

- How it integrates sustainability into its decision-making processes.
- How its remuneration policy is consistent with such requirement.
- How it ensures that its marketing communications do not contradict the disclosures under EU SFDR.

Some EU SFDR requirements apply on a "comply-or-explain" basis, meaning that an investment manager must decide whether to comply with the applicable requirement or not, and in the absence of compliance, must publish its reasons for such decision on its website and disclose such fact to investors in pre-contractual documentation. These requirements, which apply to all managers regardless of whether the products they market have an ESG focus, are set out in Part I of Annex 2.[26]

The EU SFDR also introduces additional requirements which apply to financial products that have an ESG-focus, i.e., where the product promotes environmental or social characteristics (light green financial products), or has sustainability as an investment objective (dark green financial products). The EU Taxonomy Regulation provides an additional overlay of requirements, principally for light green and dark green financial products. These additional requirements are set out in Parts II and III of Annex 2, respectively.[27]

U.K. Rules

The U.K. will introduce new disclosure requirements for FCA-authorised investment managers based on the Interim Report. The Taskforce has stated that the proposed U.K. rules are anticipated to include "disclosure of strategy, policies and processes at the firm level, covering relevant recommended disclosures; complemented by more targeted disclosures at the fund or portfolio level."[28]

The Taskforce also stated that the proposed U.K. disclosure requirements will interact "with related international initiatives, including those that derive from the EU's Sustainable Finance Action Plan", such as the SFDR. While the U.K. will adopt a similar regime, the rules are unlikely to be identical. As such, U.K. investment managers will need to consider the requirements they would have to comply with under the SFDR were that Regulation to apply.

What ESG-related Amendments Have Been Proposed to AIFMD, Recast MiFID and the UCITS Directive?

In addition to the requirements under the EU SFDR, the EU has proposed amendments to the delegated provisions of the three EU single market Directives (the recast MiFID, AIFMD and UCITS) to better embed sustainability into those firms' wider systems and processes.

Accordingly, there are amendments (the "Sustainability Amendments") proposed to:

- The suitability assessment performed by investment managers in the context of portfolio management and investment advisory services under the recast MiFID, such that those firms must incorporate a

25 https://www.akingump.com/a/web/e3C7pVoG7WCFK6MsyBGXrC/239D1w/annex-2-the-sdfr-and-taxonomy-regulation.pdf.
26 https://www.akingump.com/a/web/e3C7pVoG7WCFK6MsyBGXrC/239D1w/annex-2-the-sdfr-and-taxonomy-regulation.pdf.
27 https://www.akingump.com/a/web/e3C7pVoG7WCFK6MsyBGXrC/239D1w/annex-2-the-sdfr-and-taxonomy-regulation.pdf.
28 Interim Report of the UK's Joint Government-Regulator TCFD Taskforce, November 2020 (here).

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client's sustainability preferences as part of the wider suitability assessment.

- The risk management policies, organisational requirements and operating conditions applicable to investment managers authorised under the recast MiFID, AIFMD and the UCITS Directive.

The Sustainability Amendments have not yet been adopted by the European Commission, but once adopted are expected to apply from the second half of 2021, though further delays are possible.

The Sustainability Amendments complement the manager-level requirements under the SFDR by clarifying and setting out in more detail the manner in which an investment manager must integrate sustainability into its internal policies, procedures and organisational arrangements.

Under the proposed draft of the Sustainability Amendments, the key requirements will impact investment managers in the following areas:

- Organisational requirements: firms must incorporate sustainability risks within their existing processes, systems and controls and risk management framework.
- Conflicts of interest: when identifying the types of conflicts of interest that may damage the interests of the investment fund or client, firms must include those arising from sustainability preferences.
- Risk management: the firm's compliance and audit functions must consider sustainability risks as part of the wider risk management process.
- Investment due diligence: firms must take into account sustainability risks when complying with applicable investment due-diligence requirements.
- Product governance: high-level requirement on firms to consider their clients' ESG preferences (where relevant) and whether any financial instrument's ESG characteristics (where relevant) are consistent with the target market.
- Suitability assessment: an express requirement clarifying that suitability assessments required in the context of portfolio management and investment advisory services provided under the recast MiFID must incorporate a client's sustainability preferences.

What is the Impact of Brexit?

As explained in the first article in this publication, Direct EU Legislation – which includes EU Regulations – which were "operative" at 11 p.m. on December 31, 2020 was "incorporated" into U.K. law under the terms of the EUWA 2018.

The main provisions of the EU SFDR and the EU Taxonomy Regulation were not, however, operative at the end of the Transition Period, as the main provisions only take effect from a future date, and so these EU Regulations were not incorporated into U.K. law and there is no U.K. parallel version of these Regulations.

For completeness, we note that there were some procedural provisions of these Regulations which were operative on IP completion day, for example, provisions requiring the development of delegated regulations. As it makes no sense for just these procedural provisions to take effect, however, the U.K. Government has ensured that they were "omitted" from the incorporation process through the issuance of Exit Regulations.[29]

Do the New EU Rules Have an Extraterritorial Reach?

The extraterritorial application of the EU SFDR to U.K. and other non-EU investment managers is currently unclear, but the broad drafting of the EU SFDR and certain guidance provided by the European Commission suggest the possibility that "financial markets participants" and "financial products" could also include non-EU investment managers, such as when marketing a non-EU fund under a national private placement regime in the EU.

The Joint Committee of the European Supervisory Authorities (ESAs) responsible for drafting the regulatory technical standards under the EU SFDR has written to the European Commission seeking clarity on "several important areas of uncertainty in the interpretation of SFDR," including on its extraterritorial application.[30] Specifically, the ESAs have sought clarity about whether "SFDR applies to non-EU AIFMs, for example when they market a sustainable EU Alternative Investment Fund under a National Private Placement Regime."

Guidance issued by the European Commission and the Technical Expert Group on Sustainable Finance in relation to the EU Taxonomy Regulation notes that the disclosure obligations for financial market participants in the EU Taxonomy Regulation apply to "anyone offering financial products in the EU, regardless of where the manufacturer of such products is based".[31]

29 See Regulation 22 of The Financial Services (Miscellaneous Amendments) (EU Exit) Regulations 2020 (here) and Regulation 77 of The Securities Financing Transactions, Securitisation and Miscellaneous Amendments (EU Exit) Regulations 2020 (here).

30 Letter from Steven Maijoor to the European Commission on Priority Issues Relating to SFDR Application, January 7, 2021 (here).

31 FAQs about the work of the European Commission and the Technical Expert Group on Sustainable Finance on EU Taxonomy

The guidance goes on to state that this approach "is no different to other corporate or financial product disclosure obligations already in place in the EU. The international influence of the EU Taxonomy will exist despite there being no intention to bind third countries on their own sustainability or sustainable finance activities."[32] By analogy, the existing product governance rules under MiFID II require EU firms to provide certain disclosures with respect to funds they market, regardless of where the fund or its manager is located. The rules do not, however, apply directly to non-EU managers.

Until the European Commission provides definitive guidance regarding the extraterritorial application of the disclosure requirements under the EU SFDR and the EU Taxonomy Regulation, certain EU jurisdictions may apply the EU rules more widely, e.g., by requiring non-EU fund managers to comply with the disclosure requirements as an additional condition for marketing under the applicable private placement regime in that jurisdiction.

Accordingly, it is useful to distinguish between requirements that apply to the financial product and those that apply to the investment manager. The ESAs have published draft "product disclosure templates" intended to standardise the format of product-level disclosures.

In any event, the EU SFDR will be relevant to all investment managers marketing to EU investors, as they will be expected to disclose information that allows EU investors to carry out appropriate due diligence and make investments consistent with their regulatory obligations.

Further, the EU-wide application is also likely to have an impact on the delegated portfolio management arrangements where non-EU investment managers provide investment management services to EU AIFMs, UCITS management companies and MiFID investment firms.

SRD II

The revised Shareholder Rights Directive II[33] (SRD II) amended the first Shareholder Rights Directive[34] from June 10, 2019. One of the policy aims for introducing SRD II was to encourage "greater involvement of shareholders in corporate governance … [to help] improve the financial and non-financial performance of companies, including as regards environmental, social and governance factors, in particular as referred to in the Principles for Responsible Investment, supported by the United Nations".[35]

As a directive, EU Member States were required to implement provisions of SRD II into their domestic law, and in almost all cases, it is necessary to look to national law to determine precisely what is required.

In the U.K., several government departments issued amendments to their rules or statutory instruments to implement SRD II, and these have all been "saved" in U.K. domestic law in accordance with EUWA 2018 as explained in the first article in this publication. For its part, the FCA undertook the process for investment managers and certain institutional investors. The FCA and the Financial Reporting Council (FRC), which sets and oversees the U.K.'s Corporate Governance Code and Stewardship Code, in parallel, consulted on the necessary amendments and issued a joint discussion paper on building a regulatory framework for effective stewardship. Please see below for further details of the ESG considerations under the U.K. Stewardship Code.

In line with the global nature of the U.K.'s investment management industry, the FCA's final rules adopted a broader geographical scope for the U.K.'s rules than was strictly required by SRD II. Consequently, the FCA's SRD rules apply not only to all investments managed in, or shares traded on, EEA markets (the minimum requirement in SRD II), but also to those managed or traded on markets outside the EEA.

Engagement Policy

Under SRD II, investment managers and institutional investors are required to publish a "shareholder engagement policy" or publicly disclose an explanation as to why they have chosen not to implement such a policy.

The shareholder engagement policy should address how the firm:

- Integrates shareholder engagement in its investment strategy.
- Monitors investee companies on certain listed matters (strategy, financial and non-financial

& EU Green Bond Standard (here).

32 FAQs about the work of the European Commission and the Technical Expert Group on Sustainable Finance on EU Taxonomy & EU Green Bond Standard (here).

33 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02007L0036-20170609.

34 https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32007L0036.

35 Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (here).

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performance and risk, capital structure and ESG considerations).

- Conducts dialogue with investee companies.
- Exercises voting rights/other rights attached to shares.
- Cooperates with other shareholders.
- Communicates with investee company stakeholders.
- Manages actual and potential conflicts of interest relating to the firm's engagement as a shareholder.

Investment managers are also required to provide an annual disclosure explaining how their shareholder engagement policy has been implemented. This includes setting out how the firm has cast votes in significant general meetings of companies in which it holds shares, only excluding votes that are insignificant due to the subject matter or the size of the firm's shareholding in the company. There must also be a description of the voting behaviour undertaken by or on behalf of trustees and any use of the services of proxy advisers.

The regulators' efforts to increase transparency with respect to voting behaviour is intended to enable market participants to evaluate more effectively whether a firm's actions in practice accord with its published shareholder engagement policy, as well as demonstrating the utilisation of shareholder/ investor engagement as an effective tool for ensuring responsible investment.

The engagement policy of a firm and the annual disclosure about how the engagement policy has been implemented must be freely available on the website of the firm.

Transparency as Regards Investment Strategy and Arrangements with Investment Managers

Certain institutional investors must disclose how the main elements of their equity investment strategy are consistent with their liability profile and duration (in particular long-term liabilities) and how these elements contribute to the medium to long-term performance of their assets. Additionally, institutional investors are required to disclose information on how their external investment managers implement their policies in the course of discretionary investment management arrangements. This information must include:

- How the arrangement with the investment manager incentives the investment manager to align its investment strategy with the profile and duration of the investor's liabilities (particularly long term liabilities).
- How the arrangement with the investment manager incentives the investment manager to make investment decisions based on assessments of medium-to long-term financial and non-financial performance of investee companies, and for the investment manager to engage with investee companies in order to improve medium-to long-term performance.
- How the method and time horizon of the evaluation of the investment manager's performance and the remuneration it receives for services are in line with the investor's liabilities, in particular its long-term liabilities.
- How the investor monitors portfolio turnover costs incurred by the investment manager, and how it defines and monitors a targeted portfolio turnover/ range of turnovers.
- The duration of the arrangement with the investment manager.

Transparency by Investment Managers

In turn, investment managers must disclose to the institutional investors for whom they invest how their investment strategy and its implementation complies with the arrangement with the institutional investor, and how it contributes to the medium-to long-term performance of the assets of the institutional investor or fund. This disclosure to an institutional investor must include reporting on:

- Key medium-to long-term risks associated with the investment.
- Portfolio composition.
- Turnover and turnover costs.
- The use of proxy advisers in engagement activities.
- The firm's policy on securities lending (and how this supports the firm's engagement activities, if applicable, particularly at the time of general meetings).
- Whether/how the investment manager makes investment decisions based on the evaluation of medium-to long-term performance of an investee company (including non-financial performance, such as ESG considerations).
- Whether conflicts of interest have arisen in connection with engagement activities, and (if so) how the firm has dealt with them.

Unless already publicly available, the disclosure should be included in the annual reports of investment funds required under AIFMD or the UCITS Directive or in the periodic client reports required under the recast MiFID.

Extra-territorial Impact of SRD II

Non-EU investment managers may be indirectly in scope of the requirements of SRD II by virtue of their carrying on services on a delegated basis for investment managers in the EU or the U.K. subject to SRD II, i.e., contractual arrangements may require U.S. investment advisers to provide details of their policies and procedures as regards shareholder engagement so as to allow the EU or U.K. investment manager to comply with its obligations under SRD II.

Stewardship Code

In January 2019, the FCA and the FRC issued proposals to revise the existing U.K. Stewardship Code (published in 2010 and updated in 2012) relating to stewardship in the institutional investment community.

The 2020 Stewardship Code ("2020 Code") which took effect on January, 1 2020, imposed a number of voluntary "comply-or-explain" principles for signatories, including asset managers, asset owners and services providers. The FCA had intended the implementation of SRD II to act as an important baseline in a continuum of measures aimed to drive effective stewardship and the 2020 Code is intended to encourage higher standards beyond that baseline, particularly in relation to how asset owners are mobilised to hold investment managers to accountable to stated investment policies and considerations.

Signatories are expected to take account of material ESG factors both when making investment decisions and when undertaking stewardship of the assets.

Signatories are also expected to make public reports of information regarding issues they have prioritised when assessing investments, and to explain how the integration of stewardship and investment has differed for different funds, asset classes and geographies.

The 2020 Code includes 12 principles for asset managers and owners concerned with purpose and governance, investment approach, and the engagement with and exercise of rights and responsibilities over investee companies.

- **Principle 1** provides that signatories should explain how their purpose and investment beliefs have guided their stewardship, investment strategy and decision-making, and an assessment of how effective they have been in serving the best interests of clients and beneficiaries.
- **Principle 2** says that a firm should disclose how effective its chosen governance structures and processes have been in supporting stewardship, and how these may be improved.
- **Principle 3** asks signatories to disclose examples of how they have addressed actual or potential conflicts of interest.
- **Principle 4** says that signatories should disclose an assessment of their effectiveness in identifying and responding to market-wide and systemic risks and promoting well-functioning financial markets.
- **Principle 5** provides that a firm should explain how internal reviews have led to continuous improvement in the firm's stewardship policies and procedures.
- **Principle 6** says that firms should explain how they have taken into account client and beneficiary needs and communicated the activities and outcomes of their stewardship activities and investments to them.
- **Principle 7** states firms should explain how information gathered through stewardship has informed acquisition, monitoring and exit decisions, whether acting directly or on the firm's behalf, and how this has best served clients/beneficiaries.
- **Principle 8** says that firms should explain how the services provided by service providers meet the firm's needs, and/or the actions that have been taken when their expectations from services providers have not been met.
- **Principle 9** asks signatories to describe outcomes of its shareholder engagement activity, whether it is ongoing, or activities which have concluded in the preceding 12 months.
- **Principle 10** provides that signatories should describe the outcomes of collaborative engagement activities.
- **Principle 11** says that firms should describe the outcome of any escalation of their stewardship activities which has been undertaken to influence issuers.
- **Principle 12** states that, in relation to list equity assets, firms should provide examples of the outcomes of resolutions on which they have voted in the preceding year.

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4. New U.K. Prudential Regime for Investment Firms

The FCA is consulting on proposed new rules introducing the U.K. Investment Firm Prudential Regime (U.K. IFPR), and on December 14, 2020, the first Consultation Paper (CP20/24) was published.[36] The U.K. IFPR will streamline and simplify the current prudential requirements for FCA-authorised investment firms in the U.K. As the FCA has stated, the coming U.K. IFPR "represents a major change for investment firms" and "it is critical that firms adequately prepare for the regime."[37]

Together with the Consultation Paper, the FCA published draft rules to introduce a new Prudential Sourcebook for MiFID Investment Firms (MIFIDPRU) as well as related guidance and associated amendments to the FCA Handbook. The FCA has also published the proposed a new reporting template[38] under the U.K. IFPR and the related reporting instructions.[39]

The U.K. IFPR is substantially consistent with the EU Investment Firms Regulation[40] (EU IFR) and the EU Investment Firms Directive[41] (EU IFD), which together introduce a new EU prudential regime for investment firms. The U.K. IFPR will "achieve the same overall outcomes" as those achieved under the new EU rules.[42]

We outline below certain key changes to the capital requirements for investment firms.

36 "A new UK prudential regime for MiFID investment firms", FCA Consultation Paper CP20/24, December 2020 (see here).
37 Paragraph 1.3, FCA Consultation Paper CP20/24.
38 See here.
39 See here.
40 Regulation (EU) 2019/2033 of the European Parliament and of the Council of 27 November 2019 on the prudential requirements of investment firms and amending Regulations (EU) No. 1093/2010, (EU) No. 575/2013, (EU) No. 600/2014 and (EU) No. 806/2014 (here).
41 Directive (EU) 2019/2034 of the European Parliament and of the Council of 27 November 2019 on the prudential supervision of investment firms and amending Directives 2002/87/EC, 2009/65/EC, 2011/61/EU, 2013/36/EU, 2014/59/EU and 2014/65/EU (here).
42 Paragraph 1.10, FCA Consultation Paper CP20/24.

When Will the New Rules Apply?

The U.K. IFPR will apply in the U.K. from January 1, 2022. This is six months after the EU IFR and EU IFD will apply to EU firms, which will start to apply from June 26, 2021.

To Which Firms Will the New Rules Apply?

The strict parameters of which firms the new U.K. IFPR will apply to have not yet been settled, but the current expectation is that it will apply to (i) "FCA investment firms", and (ii) "Collective Portfolio Management Investment firms" (CPMIs) (that is, AIFMs and UCITS management companies which have "top up" permissions to perform or provide investment management services or activities).

FCA Investment Firm

The term "FCA investment firm" is to be defined in the new Financial Services Bill 2021, which is expected to become law during 2021. Unless there are any further amendments prior to enactment, an "FCA investment firm" will be:

- A firm with a U.K. registered office (or head office).
- A firm which is solely authorised in the U.K. by the FCA.[43]
- A firm which constitutes an "investment firm" for the purposes of Article 2(1)(2) of the U.K. Capital Requirements Regulation (U.K. CRR).[44]
- Which is not specifically excluded from the definition of "investment firm" under the U.K. Regulated Activities Order (RAO).

A firm is an "investment firm" within the meaning of the U.K. CRR if both of the following conditions apply:

- It meets the definition of U.K. investment firm within the meaning of Article 2(1A) of the U.K. Markets in Financial Instruments Regulation: in brief, this means that it is a firm "whose regular occupation or business is one or more investment services to third parties or the performance of one or more investment activities on a professional basis".

43 That is, it is not also authorised by the PRA.
44 That is, the version of Regulation (EU) 575/2013 which was incorporated into U.K. law under EUWA 2018 at IP completion day.

- "Investment services and activities" are then defined by reference to Schedule 2 to the RAO. It can be noted that the services and activities listed in Schedule 2 to the RAO are materially the same as those that apply under the parallel definition in EU MiFID.[45]

- It is not subject to a specific exclusion in the U.K. CRR, for example, the firm must not be a "credit institution".

The exclusions from the definition of "investment firm" in the RAO are found in Schedule 3, and include managers of collective investment undertakings, such as AIFMs and UCITS management companies (though see the following subsection).

CPMIs

As stated above, the definition of FCA investment firm excludes AIFMs and UCITS management companies. The FCA has indicated, however, that AIFMs and UCITS management companies which have opted to "top up" their permissions to allow them to perform investment management services will be brought within the U.K. IFPR regime. These firms with "top up" permissions are referred to in the FCA Handbook as CPMIs.

Beyond stating that it will apply in some manner, the FCA has not yet explained in detail how it intends to apply the U.K. IFPR to CPMIs.[46]

Overview of the New Rules

The current EU and U.K. prudential regimes for investment firms are based on requirements that were designed for banks, and therefore the rules were "not designed to address the potential harm posed by FCA investment firms, to their clients and the markets in which they operate."[47]

By contrast, the new EU and U.K. regimes are specifically designed for investment firms and will simplify the current approach by creating a single prudential regime for all investment firms. This will cause a marked departure for some investment firms that will have to comply with meaningful capital and liquidity requirements for the first time.

Categorisation of Investment Firms

The current U.K. prudential categories relevant to investment firms, such as BIPRU, IFPRU and Exempt-CAD firms, will cease to exist. Under the U.K. IFPR there will only two categories of investment firms under MIFIDPRU: firms which are Small and Non-Interconnected (SNIs) and firms which are not SNIs ("non-SNIs"). SNIs are not permitted to trade on their own account or hold client money or assets. The SNI category will typically include non-complex asset managers and advisers. SNIs will benefit from a proportionate application of the rules (i.e., less onerous requirements) in key areas such as calculating capital requirements, reporting, disclosures and remuneration requirements.[48]

Prudential Consolidation

Firms that form part of a group will be subject to prudential requirements on a consolidated basis.[49] The FCA is also proposing to introduce a group capital test for FCA investment firm groups that do not wish to be subject to prudential consolidation provided they meet certain specified conditions.[50] The requirement calculations in such cases will differ from the current regime.

Composition and Currency of Own Funds

The regulatory capital of an investment firm will be made up of only "common equity tier 1 capital", "additional tier capital" and "tier 2 capital".[51] The FCA believes that improving the quality of regulatory capital "will lead to [investment firms] being more resilient and having an increased capacity to absorb losses."[52] Significantly, firms currently categorised as BIPRU firms or Exempt-CAD firms will no longer be able to use existing definitions of capital such as "tier 3" (short-term subordinated debt) to meet their own funds requirements under the U.K. IFPR.

The currency used under the U.K. IFPR will be pound sterling, but it is expected that threshold amounts will be equivalent to the corresponding requirements in euros under the EU prudential regime.[53]

Amount of Own Funds

The "Own Funds Requirement" will be the higher of the "Fixed Overheads Requirement" and the "Permanent Minimum Capital Requirement" for an SNI investment firm;[54] and the highest of the Fixed Overheads Requirement, the Permanent

45 The principal difference between the definitions is that the U.K. definitions refer to instruments traded on U.K. markets and the EU definitions refer to instruments traded on EU markets, although there are also certain other consequential changes.
46 Paragraph 1.5, FCA Consultation Paper CP20/24.
47 Paragraph 1.19, FCA Consultation Paper CP20/24.
48 Paragraph 2.13, FCA Consultation Paper CP20/24.
49 Chapter 3, FCA Consultation Paper CP20/24; Draft MIFIDPRU 2.5, Prudential Consolidation.
50 Draft MIFIDPRU 2.4.17R.
51 Draft MIFIDPRU 3.2.1R.
52 FCA Consultation Paper CP20/24, paragraph 1.27.
53 Paragraph 1.40, FCA Consultation Paper (CP20/24), December 2020.
54 Draft MIFIDPRU 4.3.3R.

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Minimum Capital Requirement and the new "K-Factor Requirement" for a non-SNI investment firm.[55]

Permanent Minimum Capital Requirement (PMR)[56]

The PMR is determined by reference to the MiFID investment services and activities performed. Firms that only provide portfolio management, investment advice, the reception and transmission of orders or the execution of orders on behalf of clients will have a PMR of £75,000.[57]

Fixed Overheads Requirement (FOR)

The FOR will be at least 25 percent of the fixed overheads of the previous year.[58] Firms that are only authorised to provide investment advice or the reception and transmission of orders (i.e., Exempt-CAD firms) will have to calculate their FOR the first time under the U.K. IFPR. Consequently, any such firms with high fixed overheads (e.g., due to high salaries) may be required to hold significantly more capital. The draft rules include a five-year transitional period during which such firms are required to scale up their capital to meet the FOR (or K-Factor Requirement).[59]

K-Factor Requirement (KFR)

The KFR is a new risk-based formula consisting of various components (each, a "K-Factor") with the resulting total being the applicable capital requirement (if higher than the PMR and FOR).[60] The KFR reflects the risks and potential harm that an investment firm may cause in relation to three different risk groups: Clients, the Financial Markets in which it operates and the Firm itself.

- **Clients**: The K-Factors for this group are assets under management (K-AUM), client money held (K-CMH), assets safeguarded and administered (K-ASA) and client orders handled (K-COH).
- **Financial Markets**: The K-Factors for this group are clearing margin given (K-CMG) and net position risk (K-NPR).
- **The Firm Itself**: The K-Factors for this group are concentration risk (K-CON), daily trading flow (K-DTF) and trading counterparty default risk (K-TCD).

Although the capital requirements under the KFR are potentially uncapped, in the ordinary course, the K-Factors that will be relevant to investment managers or adviser-arrangers will generally be the K-AUM and the K-COH. We set out below a summary overview of key concepts regarding the calculation of the K-AUM and K-COH by investment firms based on the FCA Discussion Paper (DP20/2) of June 2020.[61]

- **K-AUM**

  K-AUM is the K-factor requirement for the amount of own funds investment firms are required to hold against risks associated with managing assets for clients. It covers both assets managed on a discretionary portfolio management basis (e.g., a managed or segregated account) and assets under an ongoing non-discretionary advisory arrangement (i.e., the provision of investment advice). For such purpose, "assets under management" means "the value of assets that an investment firm manages for its clients under both discretionary portfolio management and non-discretionary arrangements constituting investment advice of an ongoing nature."[62]

  Inclusions and Exclusions

  Where an investment firm has delegated the management of assets to another "financial entity" (e.g., a sub-investment manager), the investment firm must include those assets within its K-AUM calculation. However, if the investment firm manages the assets of another financial entity (e.g., an AIFM) on a delegated basis, those assets may be excluded from its K-AUM calculation.

  Although the term "financial entity" is not defined in the rules, the FCA states that this includes AIFMs and UCITS management companies with 'top up' permissions because "these types of entities are subject to an AUM-based capital requirement" under the AIFM and UCITS regulatory regimes, respectively.[63]

  The position of a non-U.K. entity delegating to a U.K.-subsidiary/affiliate must be assessed on a case-by-case basis against the capital requirements (if any) to which the non-U.K. entity is subject. The FCA states that "any third country entities that have comparable AUM-based capital requirements would

55 Draft MIFIDPRU 4.3.2R.
56 Draft MIFIDPRU 4.4; the initial capital requirement for a firm to be authorised will be the same as the PMR (Draft MIFIDPRU 4.2, Initial Capital Requirement). The initial capital requirement applies only at the point at which the FCA is first granting permission to an investment firm to carry on investment services and/or activities. After a firm has been authorised, the PMR applies on an ongoing basis instead.
57 Draft MiFIDPRU 4.4.4R; such firms are not permitted to hold client money or client assets in the course of their MiFID activities.
58 Draft MIFIDPRU 4.5; in paragraph 5.4 of the FCA Consultation Paper CP20/24 the FCA states that it will cover how a firm should calculate the FOR in a subsequent Consultation Paper.
59 Draft MIFIDPRU Transitional Provisions (TP) 2, 2.10R.
60 Draft MIFIDPRU 4.6.

61 "A new UK prudential regime for MiFID investment firms", FCA Discussion Paper DP20/2, June 2020: here.
62 Paragraph 6.13, FCA Discussion Paper DP20/2, June 2020.
63 Paragraph 6.18, FCA Discussion Paper DP20/2, June 2020.

seem to satisfy the aim of avoiding 'double counting'. However, where the delegating entity does not have to meet an AUM-based capital requirement, then there is no 'double counting'. In this case, it would seem that the investment firm receiving the delegation should not exclude the relevant value of assets when measuring the total of its AUM."[64] In the US, investment advisers registered with the Securities and Exchange Commission (SEC) are not subject to regulatory capital requirements based on their AUM, though the amount of capital held by the adviser is typically assessed and reviewed by the SEC during examinations.

Calculation

The FCA has not yet published the draft MIFIDPRU provisions on the calculation of the K-AUM. However, in the June 2020 Discussion Paper, the FCA stated that an investment firm should calculate the K-AUM by using the value of total AUM on the last business day of each of the preceding 15 months. The investment firm should then exclude the three most recent monthly values and calculate the monthly average of the remaining twelve monthly values of that period, to determine the rolling average. The rolling average of that period is then multiplied by the K-AUM coefficient of 0.02 percent, with the result being the minimum capital required to fulfil the K-AUM. An investment firm must update its K-AUM calculation on the first business day of each month.[65]

- **K-COH**

K-COH is the K-factor requirement for the amount of own funds investment firms are required to hold against potential risks from both the execution of orders in the name of the client and the reception and transmission of client orders (e.g., mistakes in handling of client orders, including failing to deliver best execution).

Inclusions and Exclusions

The K-COH excludes orders executed in the name of the investment firm, including if on behalf of clients (which are instead captured under a separate K-Factor). The K-COH includes transactions executed by the investment firm when providing delegated portfolio management services on behalf of investment funds. Also included within K-COH are transactions arising from investment advice where an investment firm does not calculate the K-AUM (as discussed above).

To avoid double-counting, the K-COH excludes transactions handled by the investment firm for servicing a client's investment portfolio where those assets are under its management and already included in its K-AUM calculation (e.g., a managed account or segregated portfolio). Further, the K-COH also excludes transactions for assets managed by an investment firm under a delegation where the financial entity delegating the assets to the investment firm already includes such assets within its own AUM-based capital requirement (as discussed above).

Also excluded from the K-COH, are situations where "two or more investors are brought together to facilitate a transaction between themselves, where the investment firm is not part of a chain (with other investment firms or entities that may conduct MiFID investment business) for client orders."[66] The FCA stated that such situations are most likely to occur in corporate finance or private equity business.

Calculation

The FCA has not yet published the draft MIFIDPRU provisions on the calculation of the K-COH. However, in the June 2020 Discussion Paper, the FCA stated that an investment firm should calculate the K-COH on the first business day of each month. To do so, the investment firm should record separately the total daily value of client orders handled for both cash trades (measured as the total value either paid or received on each trade) and derivatives trades (measured as the notional amount of the contract traded), for each business day over the previous six months.

Using the first three months of daily data (i.e., excluding the three most recent months' worth) an investment firm must calculate the average total daily value traded separately for both cash and derivatives trades. The average total daily value for cash trades must then be multiplied by the coefficient of 0.1 percent and the average total daily value of derivatives trades must be multiplied by the coefficient of 0.01 percent. The sum of these figures for cash trades and derivatives trades will be the minimum own funds requirement an investment firm must hold for its K-COH.[67]

64 Paragraph 6.18, FCA Discussion Paper DP20/2, June 2020.
65 Paragraph 6.12-16, FCA Discussion Paper DP20/2, June 2020.
66 Paragraph 6.44, FCA Discussion Paper DP20/2, June 2020.
67 Paragraph 6.36, FCA Discussion Paper DP20/2, June 2020.

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5. Market Abuse

Because of the pandemic, many issuers have sought additional capital or been in financial distress, and as such, the pandemic has been a catalyst for significant amounts of inside information in the market. Consequently, ensuring that suitable systems and controls in place for dealing with inside information and ensuring good market conduct has never been more important. At the same time, however, firms have had to cope with the forced move to working from home, which has only made the oversight of employees harder.

2020 was therefore a trying time for firms' working to meet their market abuse obligations: heightened opportunities for falling foul, and the need to use adapted systems and controls for the remote working environment: a subject the FCA has recently issued further guidance on.[68]

In the early days during the U.K.'s first national lockdown, the FCA acknowledged that firms would face challenges, but the Regulator maintained that there was still an expectation that firms would "continue to act in a manner that supports the integrity and orderly functioning of financial markets".[69]

Since then, the FCA has become even firmer in its view: whatever slim latitude might have been afforded to firms at the beginning of the lockdown – and it is not clear that there was ever much leeway – the FCA's expectation nearly 10 months on is that "going forward, office and working from home arrangements should be equivalent".[70]

68 https://www.fca.org.uk/publications/newsletters/market-watch-66.
69 https://www.fca.org.uk/publication/newsletters/market-watch-63.pdf.
70 https://www.fca.org.uk/news/speeches/market-abuse-coronavirus.

This article explains some of the recent guidance, advice and trends from the FCA on what firms must be doing to ensure they are upholding the standards required of them in the current climate.

Issues to Focus On

In May 2020, the FCA issued guidance on the areas which it "encourage[d] particular focus on" during the pandemic.[71] Whilst the advice is now a good number of months old, it is by no means stale – not least because the U.K. is again in a lockdown. The FCA highlighted the following:

- Ensuring inside information continues to be appropriately identified and handled by all persons involved in the information chain so that it is not misused for insider dealing or for commercial advantage.
- Ensuring inside information is appropriately disclosed by issuers so that investors are not misled.
- Maintaining robust market surveillance and suspicious transaction and order reporting (STORs) by relevant market participants, in the context of changes in market conditions and the current use of alternative working arrangements.
- Meeting the transparency and short position covering requirements under the Short Selling Regulation for market participants to support the effective functioning of the market.
- Identifying and managing conflicts of interest by market participants that may arise around capital raising events.

In particular in relation to the reporting obligations placed on firms under the EU or U.K. Market Abuse Regulations or under other legislation, firms should have considered whether these have changed in practice or in substance, and in particular whether the report is being made to the correct regulator or regulators.

FCA's Risk Assessment

In October 2020, the FCA's Director of Market Oversight, Julia Hoggett gave a speech explaining what had been learned as the FCA gathered more

71 https://www.fca.org.uk/publication/newsletters/market-watch-63.pdf.

and more information throughout the course of the pandemic.[72] The conclusion she drew was that the pandemic had not necessarily given rise to new types of market abuse risk, but rather the "relative prevalence of certain risks" had changed. The FCA had therefore performed an updated "risk assessment" exercise to show how it should shift its supervisory and enforcement focus.

Three themes arose from that risk assessment, which are now informing how the FCA is approaching its role as regulator of market conduct, namely:

- The risks deriving from the increased scale of primary market activity during the pandemic.
- The challenges of surveillance during volatile markets.
- The challenges of surveillance driven by new ways of working, and the importance of culture to manage those risks.

Each of these is discussed in turn.

Primary Markets

As mentioned above, the pandemic has seen an increased need for re-financing among numerous businesses, and this type of capital raising activity has the potential to give rise to a high volume of inside information. As a result, institutions must be especially careful in this environment to ensure that they have appropriate controls over this information and that effective information barriers remain in place even in the remote workplace. Firms are also encouraged to have dynamic risk assessment measures in place, which are able to capture the impact of the changing environment of the past year. This has meant that the nature of the information that is 'material' to a business' prospects may have changed.

In her speech in October 2020, Ms. Hoggett gave examples of the potential types of inside information to be especially aware of, including:[73]

- Knowledge that an entire businesses' operations would have to shut, or indeed could open again.
- Knowledge of whether a company had utilised the furlough scheme or any of the pandemic lending schemes.
- Information about the pace of cashflow burn.

She noted that these were "all issues that might either not have come up in the past, or not have been material, but which now are".

Firms must therefore be alert to the kind of information that is likely to affect their valuation, and be prepared to discuss a wider range of issues at their disclosure committees. For those who hold insider information, a clear reminder of the fact that tipping off offences are being closely monitored comes in the form of a recent investigation by the French regulator, the Autorités des Marchés Financiers (AMF), which brought charges against a corporate insider for transmitting insider information to a London analyst regarding the acquisition by Campari of shares in SPML (the owner of Grand Marnier). These actions saw the deputy managing director and chief financial officer of SPML, and the analyst who received the information, each receive fines of €50,000.[74]

Furthermore, with many companies committing to remote working well into 2021, firms must ensure that their working from home arrangements have contingencies in place to deal with the new risks associated with identifying and handling such inside information in this environment. The FCA suggestion has been to have firms "re-affirm that persons on insider lists continue to be aware of when they have access to insider information and their legal and regulatory duties in relation to insider dealing and the unlawful disclosure of that information".[75] Issuers should also take care to verify that, in complying with their U.K. MAR (and EU MAR) obligations to disclose inside information, their announcements are "complete and accurate and contain no false or misleading information".[76]

Surveillance in Volatile Markets

What has become clear over the past year is that the pandemic has led to a dramatic increase in trading activity and volatility, which has presented new challenges for firms. Again in her October 2020 speech Ms. Hoggett reminded firms that "Whilst the fundamentals of the market abuse offences are constant, the ways in which the risk may manifest are not. The manner of surveilling for them must, therefore, also change."[77] Where firms are made aware

72 https://www.fca.org.uk/news/speeches/market-abuse-coronavirus.
73 https://www.fca.org.uk/news/speeches/market-abuse-coronavirus.
74 COLUMN: Improper selective disclosure and insider dealing – AMF fines corporate tipper, London analyst http://go-ri.tr.com/IBlbNF.
75 https://www.fca.org.uk/publication/newsletters/market-watch-63.pdf.
76 https://www.fca.org.uk/publication/newsletters/market-watch-65.pdf.
77 https://www.fca.org.uk/news/speeches/market-abuse-coronavirus.

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of suspicious activity as a result of their surveillance mechanisms, they must continue to assess the evidence, apply context and make informed decisions so that they are able to submit high quality STORs, notwithstanding the exceptional market conditions which have led to an increase in alerts.

Additionally, Market Watch 65[78] served as a reminder to firms that they should be careful not to include information in these reports that are submitted to the FCA that could be subject to legal professional privilege, as to do so would run the risk that any claimed privilege may be deemed to have been waived or lost.

The volatility of the current market has similarly been noted by ESMA, which has highlighted that the COVID-19 pandemic continues to constitute a serious threat to the orderly functioning and integrity of financial markets. This has had a particular impact on regulatory approaches to net short positions, which have the potential to exacerbate such market volatility, and as a result, the threshold for reporting net short positions has been lowered to 0.1 percent from its previous 0.2 percent threshold.[79] This measure was extended when ESMA reviewed these regulations as of December 17, 2020 due to the continuing problems presented by COVID-19.[80] The FCA is taking breaches of these reporting thresholds seriously, as evidenced by the recent enforcement proceedings against Asia Research and Capital Management Ltd for such a failure: further details on this case are listed in the regulatory round up in the Key Cases and Enforcement Round-Up below.

New Ways of Working

As the long-lasting effects of the COVID-19 pandemic stretch on into the New Year, and the major shift in the manner in which many firms conduct their business continues, the FCA has been quick to remind firms of the potential regulatory concerns when working from home, particularly with regard to the use of personal devices.

Whilst remote working posed an initial challenge for recording and surveillance, and in line with the regulatory expectation that home and office should be equivalent, the FCA has affirmed its stance that "this is not a market for information that [they] wish to see be arbitraged."[81] In Ms. Hoggett's speech, she noted specifically that firms are expected to have "refreshed their training and put in place rigorous oversight reflecting the new environment – particularly regarding the risk of use of privately owned devices",[82] and policies should prevent the use of personal devices for relevant activities where recording is not possible. Whilst means of communication may be changing, the regulatory obligations have not. As such, it seems that the use of technology remains a hot spot for FCA attention, be that where it forms part of the regular working environment, or where it arises in connection with regulatory breaches. In either case, firms should be alert to the use of technology by their employees, and ensure – as Ms. Hoggett noted – that compliance teams leave staff in "no doubt about the standards expected from them", and that these standards apply whether they are "in the regular office, a disaster recovery site or at a makeshift workstation at home".[83]

Market Watch 66

In January 2021, the FCA issued Market Watch 66,[84] providing further guidance on its expectations for firms in relation to recording telephone conversations and monitoring electronic communications. The FCA particularly noted that the move to working from home had appeared to lead to a shift in personnel to using "unmonitored and/or encrypted communication" apps, including WhatsApp. The FCA reiterated how important it was for firms to ensure that if any such apps were used for "in-scope activities" – including arranging deals, dealing in investments, managing investments, managing AIFs/UCITS, or establishing, operating or winding up collective investment schemes – the firm must be able to record and audit those messages. This is on top of the requirement to record certain telephone conversations, which also must be upheld whilst individuals are working from home. The FCA stated that it had already acted against firms and individuals for the misuse of WhatsApp and other communication platforms when they had been used to arrange deals or provide investment advice.

The FCA has stressed that firms must have "robust" policies in place to manage, record and audit how personnel make communications, and that these policies should be supported by suitable training.

78 https://www.fca.org.uk/publication/newsletters/market-watch-65.pdf.

79 https://www.esma.europa.eu/press-news/esma-news/esma-requires-net-short-position-holders-report-positions-01-and-above.

80 https://www.esma.europa.eu/press-news/esma-news/esma-renews-its-decision-requiring-net-short-position-holders-report-position-1.

81 https://www.fca.org.uk/news/speeches/market-abuse-coronavirus.

82 https://www.fca.org.uk/news/speeches/market-abuse-coronavirus.

83 https://www.fca.org.uk/news/speeches/market-abuse-coronavirus.

84 https://www.fca.org.uk/publications/newsletters/market-watch-66.

What Has the FCA Been Doing?

The FCA has made efforts to ensure that market abuse doesn't fall through the cracks, and this has partly been made possible by the updates to the internal surveillance systems. In a speech in February 2020, Mark Steward, FCA Executive Director of Enforcement and Market Oversight, noted that this system has made it easier to look for manipulative trading than under the previous process where detection relied on transaction data alone.[85] He noted that the new process has resulted in a big change in the character of the FCA's investigation work, which was previously dominated by suspected insider dealing cases, with the split now sitting 60:40 between insider dealing and manipulation. Indeed, it was the FCA's internal surveillance system that uncovered the market manipulation in the Corrado Abbattista case involving alleged fake spread betting orders – further detail of which can be found in the Key Cases and Enforcement Round-Up below.

Market abuse has been an FCA priority for some time, with such cases representing over 20 percent of open enforcement investigations at the end of March 2020.[86] They also accounted for the largest category of cases. With the recent Abbattista and Redcentric cases, it remains clear that the FCA is continuing its fight against abusive behaviour.

85 https://www.fca.org.uk/news/speeches/market-integrity-and-strategic-approach.

86 https://www.fca.org.uk/data/enforcement-data-annual-report-2019-20.

6. Changing of the Guard at the FCA

There were various indications in 2020 that the FCA was in the process of a rejuvenation, and these appear to be portents of a new, potentially more activist regulator on the horizon.

New Leadership

In October 2020, Nikhil Rathi became the new Chief Executive of the FCA. Mr. Rathi is a comparative outsider for a regulatory role, having previously been the CEO of the London Stock Exchange and before that in governmental positions.

This marks a step-change from Andrew Bailey's banking policy background, which saw a focus on prudential conduct and retail whilst he was at the helm. Former FCA board member, Mick McAteer, said that Rathi's appointment "sends a powerful signal that the FCA is likely to become more internationally focused in the post-Brexit world. The regulator is likely to play a bigger role in protecting the City as a pre-eminent international financial centre, given the potential loss of business post Brexit".[87]

Change was already afoot prior to Rathi's appointment however, with the FCA announcing an internal restructure back in April 2020 that merges its retail and wholesale supervision and breaks up the strategy and competition division. Jonathan Davidson also commented on the transformation project, noting that the agency was aiming to "integrate the supervision and policy functions to take a holistic view and approach to the challenge of making financial markets work better".[88]

Soon after Mr. Rathi took office, the FCA started the hunt for a new Chief Operations Officer – whilst we are awaiting to hear who will fill this role, it is notable that the job advertisement sought a "change agent".

With these new individuals in charge, and a newly structured FCA, "more of the same" seems an unlikely path for the regulator.

87 https://www.theguardian.com/business/2020/jun/22/fca-appoints-london-stock-exchange-boss-nikhil-rathi-as-ceo.

88 https://regintel.thomsonreuters.com/#accelus/ri/%7B%22location%22%3A%22%23ri%2Fdocument%2FI4CF57810300411EB8DA089ECEA58AD02%2Fview%22%7D.

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Diversity and Inclusion

One new change in tone since the appointment of Mr. Rathi is already noticeable: the FCA is focused on diversity and inclusion, both within the organisation itself, and in those it regulates. Indeed, in his first public statement after his appointment was announced, Mr. Rathi started with his aim "to create together an even more diverse organisation", and then later told MPs that the FCA might reject firms' new director appointments if they did not see improvements in diversity at boardroom level. Since taking office, Mr. Rathi has repeated this, and in a speech at Mansion House which was otherwise focused on the pandemic, his closing remarks were about diversity and inclusion.

And it is not just Mr. Rathi who has made this new priority plain: in November, Jonathan Davidson, the FCA's Executive Director of Supervision, centred an entire speech on the FCA's diversity and inclusion aims.

Whilst the FCA has been focused on corporate culture for some time, and there have often been references to diversity and inclusion, the explicitness of the current focus strikes us as new. What effect this will have on firms remains to be seen, but we can expect there to be additional regulatory scrutiny in due course.

Insurance Test Case

The FCA established another new string to its regulatory supervisory bow in 2020, with the bringing of the Business Interruption Insurance Test Case. This case arose out of the pandemic and particularly the U.K. national lockdown which commenced in late March 2020. Because of the lockdown, businesses – and in this case, small and medium-sized businesses in particular – tried to make claims under the business interruption or disease clauses in their insurance policies. Some insurance companies, however, disputed that the relevant policies covered these events.

Faced with this, the FCA decided to bring a test case on behalf of the small and medium-sized businesses against certain insurance companies, requesting that the High Court definitively construe the relevant contractual provisions. Ultimately, the High Court's judgment was not an outright victory for either side, and it was appealed directly to the U.K. Supreme Court, which gave judgment (largely in favour of the FCA) in January 2021.

Whilst the outcome of the case is important to the insurance companies and the policy holders, the significance of the FCA's decision to instigate these proceedings is significant to the whole market. There appears to be no express statutory authorisation saying that the FCA can bring a case such as this, and the FCA has had to rely on general grants of authority to justify its ability to start the case at all.

The FCA's broad reading of its powers, and willingness to act in new ways to try to remedy perceived wrongs, certainly shows an appetite on the regulator's part to be much more activist and muscular than it has been in the past, and we can expect this type of novel regulatory intervention to continue in the coming months and years.

Response to Independent Reviews

December 2020 also saw the FCA respond to two independent reviews into its regulation of London Capital & Finance[89] (LCF) and Connaught Income Fund Series 1 and connected companies (Connaught).[90] Both reviews levied heavy criticism at the regulator for its handling of these two major enforcement actions. The FCA accepted the nine recommendations addressed solely to the FCA in the LCF Review and the five lessons identified by the Connaught Review,[91] and Charles Randell, Chair of the FCA noted:[92]

> "There are a number of things we could have done better in our supervision of these two firms and both reports highlight the need for the FCA to continue to change to better protect consumers from harm.... These reports not only highlight operational mistakes; they also indicate that the measures we introduced may not have been as effective as we wanted and challenge the balance that we struck at that time… Consumers must have trust in the FCA to do its job properly. We need to reinforce a culture in which people at the FCA are empowered and confident to take responsibility for bold interventions".

Randell did note that the FCA has already made changes in its approach to supervising firms, and that the operational transformation of the organisation

89 https://www.gov.uk/government/publications/outcome-of-investigation-into-the-fcas-regulation-and-supervision-of-lcf.

90 https://www.fca.org.uk/publication/corporate/connaught-independent-review.pdf.

91 Full responses to both reports available here and here.

92 https://www.fca.org.uk/news/press-releases/fca-responds-independent-reviews-london-capital-finance-connaught.

should go some way to "bolster trust in the FCA."[93] This was a sentiment echoed by Rathi, who stated that the reports made for "sobering reading" but that "[m]y colleagues and I are committed to implementing the recommendations and lessons learned which will require significant and necessary changes to the way we regulate, our use of data and intelligence, and our culture."[94] Rathi went on to outline a number of key actions that the FCA would take over the next six months in order to implement the recommendations levied by the reviews, including the aforementioned internal restructuring, enhancing training and taking a more proactive and joint-up approach with the government to tackle various scam activities.

93 https://www.fca.org.uk/publication/corporate/connaught-independent-review.pdf.

94 https://www.fca.org.uk/news/press-releases/fca-responds-independent-reviews-london-capital-finance-connaught.

Conclusion

The FCA sits at a pivotal moment in January 2021, with dust still to settle from the effects of Brexit and the pandemic. What is clear, however, is that the regulator appears much more engaged and innovative in its regulatory outlook than has been the case in the recent past, and all the signs are that this is going to continue.

7. Enforcement Trends

The review of the FCA's 2019/20 enforcement data from its annual report comes at an interesting point – whilst typically the report would be used to extrapolate key trends, the shadow of the COVID-19 pandemic means that much of last year's disruption, and its effects on enforcement, are yet to have been captured. That said, there is still much to learn.

Enforcement Areas of Focus

Generally, there was little change between 2018/19 and 2019/20; the number of open cases (646 compared to 647), number of fines (16 to 15), and the value of financial penalties (£227.3m to £224.9m) remained largely the same.[95] However, the remainder of 2020 has seen reports of a significant drop in enforcement cases as a result of the challenges posed by the pandemic. New enforcement cases fell by 76 percent,[96] and many open cases were closed in the early months[97] following a national lockdown and a shift to remote working, and it remains to be seen how far the FCA has managed to realign now that the turbulence of the 'first wave' has settled. The top four areas for enforcement action, making up 60 percent of all active matters, were in respect of unauthorised business, retail conduct, insider dealing and financial crime. However, the pandemic has seen the FCA place focus on preventing market abuse (see the article on Market Abuse above), so it is possible that this may become a greater target of enforcement as a direct result of the remote-working environment, and the compliance challenges this poses.

95 https://www.fca.org.uk/data/enforcement-data-annual-report-2019-20.

96 https://www.ft.com/content/76e3d194-6c64-484e-9172-bb82dc99b1d3.

Enforcement and the Pandemic

Between March 1, 2020 and May 31, 2020, the regulator opened just 35 new enforcement cases, marking a dramatic reduction from the 148 cases opened in the same period in 2019. This led some to conclude that the pandemic has seen the FCA take its foot off the pedal, but such a conclusion would be premature. Despite the reduction in opening new cases, the pandemic has seen no corresponding slowdown for cases already in the system, with a 7 percent increase in the number of warning notices issued in that period. Furthermore, these figures came from the height of disruption of working environments, and a freedom of information request by GIR[98] led to the FCA disclosing that it has started 121 cases this year, 76 since March, showing that case openings have picked up at least to

97 https://www.thetimes.co.uk/article/fca-s-reputation-is-at-risk-if-it-fails-to-defend-a-market-ripe-for-abuse-zqbqg57k0.

98 https://www.lexology.com/library/detail.aspx?g=47d0314b-0857-49ef-a295-2a4b36784d93.

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some degree now that the remote working processes are more familiar for all involved. With that in mind, firms should expect that any unintended laxity as a result of the pandemic is unlikely to roll through into 2021, and as such, any attempts to rely on the impact of COVID-19 as an excuse for failing to comply with regulatory obligations will be given short shrift.

Increased Case Duration

A major point of note is the time that it takes for a case to reach a decision. Even in the 2019/20 period, which only captured data from the very start of the shift to working-from-home, regulatory and civil cases almost universally took longer than they did in 2018/19; the average length of all cases, including 'no further action' cases, took an additional six months to reach conclusion (averaging 23.9 months) in comparison to 2018/19.[99][100] It is a natural consequence of the past year's events that a degree of further delay can be expected in this area, although an average length of almost two years to conclude an investigation where no action is taken does seem to be at the very upper limit of what could be deemed reasonable.

Increased Case Costs

Perhaps the biggest change that can be noted from this year's report is the increase in case costs. The cost of enforcement action has risen across all case types, including those resolved by agreement, referred to the Regulatory Decisions Committee (RDC) or Upper Tribunal, or where no further action was taken. In fact, average case costs more than doubled in the past 12 months, rising from £103,400 to £229,000.[101][102] This increase is particularly noticeable for cases referred to the RDC, where FCA costs rose by nearly 200 percent, from £253,500 in 2018/19 to £748,800 in 2019/20. This suggests that investigations are becoming more expensive for the FCA, and by association for firms, as the regulator passes on these increased costs. Given an increase in length of time spent on investigations is likely to be echoed in the 2020/21 data, a further corresponding increase in costs may also be anticipated.

What Can be Expected for 2020/21?

In its business plan published in April 2020,[103] the FCA set out its five key priorities for the next one to three years, one of which is described as 'transforming how we work and regulate'. Unsurprisingly, one of the ways in which the FCA plans to achieve this is by making "faster and more effective decisions".[104] This echoes the sentiment from its enforcement mission statement published at the start of the 2019/20 period, which noted "[i]t is important, from a public interest perspective, to be seen to identify and tackle misconduct quickly" and committing to "ensuring that we end investigations promptly".[105] Given the above statistics, one could be forgiven for thinking that limited progress has been made against this aim in 2020, although given the backdrop of [COVID-19] we should perhaps give the regulator the benefit of the doubt on this occasion and return to assess its progress next year. The regulator has also stated its intention to operate in a more integrated way as 'One FCA', ensuring that whatever regulatory tools it utilises, it does so "with a pace and decisiveness that matches the urgency of the issue".[106] Firms that have been on the receiving end of an investigation are acutely aware of the protracted nature of enforcement actions, so attempts to curb the rising case duration and associated costs will be widely welcomed.

Whilst the FCA makes efforts to work at greater pace in spite of recent challenges, regulated-firms should continue to pay close attention to the areas of focus identified in the report, particularly where it comes to matters that may affect vulnerable customers and those negatively affected by the pandemic. A repeated refrain from FCA communications in the past year has been around ensuring that firms have taken adequate steps to effectively navigate the changing workplace environment – principally where these make firms more susceptible to risks, such as market abuse. As discussed in the article above regarding Market Abuse, it is clear that the FCA considers there to be "a risk of less self-policing amongst front office staff",[107] given that the first line of defence in the pre-pandemic environment where "a front office employee observes, or overhears, something questionable involving a colleague nearby … may be diminished, or absent".[108] Given its repeated emphasis, enforcement action in this area in the coming months is highly likely, so firms should ensure that their compliance oversight is a watertight as possible.

99 See https://www.fca.org.uk/publication/corporate/annual-report-2018-19-enforcement-performance.pdf.

100 https://www.fca.org.uk/data/enforcement-data-annual-report-2019-20.

101 https://www.fca.org.uk/publication/corporate/annual-report-2018-19-enforcement-performance.pdf.

102 https://www.fca.org.uk/data/enforcement-data-annual-report-2019-20.

103 https://www.fca.org.uk/publication/business-plans/business-plan-2020-21.pdf.

104 https://www.fca.org.uk/publication/business-plans/business-plan-2020-21.pdf.

105 https://www.fca.org.uk/publication/corporate/our-approach-enforcement-final-report-feedback-statement.pdf.

106 https://www.fca.org.uk/publication/business-plans/business-plan-2020-21.pdf.

107 https://www.fca.org.uk/news/speeches/market-abuse-coronavirus.

108 https://www.fca.org.uk/news/speeches/market-abuse-coronavirus.

Corrado Abbattista

The FCA has clamped down on spread betting in recent months, evidenced most notably in a high profile decision on September 16, 2020, which was then confirmed on December 15, 2020. The regulator fined trader Corrado Abbattista £100,000 for manipulating equities markets by placing fake spread betting orders, as well as issuing a prohibition order that bans him from participating in any regulated activities, on the basis that he "lacks integrity and is not fit and proper to perform any function in relation to any regulated activities".[109]

Mr. Abbattista referred the FCA Enforcement's findings to the FCA's RDC, which agreed with the original findings. Mr. Abbattista had originally referred the case to the Upper Tribunal, but decided to withdraw it in late November 2020, and as such the FCA was able to issue a Final Notice with respect to the enforcement action in December.[110] This case is notable as it is the first time that the FCA has taken enforcement action against a firm or individual for committing one of the three substantive offences under MAR – namely insider dealing, market manipulation and unlawful disclosure.[111]

The FCA submitted that between January 20, 2017 and May 15, 2017, Mr. Abbattista – acting in his role a Chief Investment Officer at now-dissolved Fenincian Capital Management – placed large orders for contracts for difference (CFDs) referenced to the shares of five listed companies including Marks and Spencer Group Plc and Diageo Plc, which he did not intend to execute (misleading orders). These were placed on the opposite side of the order book to existing smaller orders which he did intend to execute (genuine orders). This action, the FCA contended, saw Mr. Abbattista falsely represent an intention to buy/sell to the market, when his true intention was the opposite. Furthermore, Mr. Abbattista almost always placed genuine orders as 'iceberg orders' where only part of the order was visible to other market participants. However, Mr. Abbattista did not use this method for the misleading orders, meaning the full size was visible, which is notable given they were for volumes of shares far larger than typical market size. As such, the FCA alleged that the misleading orders would likely "have had a material impact on other market participants", potentially causing them to alter their trading strategies, as it suggested there was a material buyer in the market, and "would have created a false and misleading impression regarding the true supply of and demand for the shares in question".[112]

This case sits alongside other spread betting cases where action has been taken by the FCA, and follows a perceived 'crackdown' on spread betting from the regulator after it took steps to limit the risks of CFD products in July 2019.[113] The regulator publicly censured former chief executive of collapsed spread betting company Worldspreads, and the imposition in 2019 of permanent restrictions on the sale and marketing of CFDs – the kind of spread bets Mr. Abbattista was found to have manipulated. Given the FCA's limited prior enforcement action in relation to market abuse investigations (only two cases in the last two financial years), it is interesting to note that Mr. Abbattista's trading was identified via the FCA's internal surveillance systems, as discussed in the article on Market Abuse above.

The case, and others like it, has also led to questions around the definition of 'spoofing' in the English courts, and the role of subjective intention for offers to be taken up, especially when compared to comparatively more prescriptive definitional rules in the United States. Spoofing is proving to be a major focus area globally, and the FCA's new tools,

109 https://www.fca.org.uk/news/press-releases/fca-publishes-decision-notice-against-corrado-abbattista-market-manipulation.

110 https://www.fca.org.uk/publication/final-notices/corrado-abbattista-dec-2020.pdf.

111 Prior to 2016, market abuse cases were brought under s118 FSMA 2000. This is the first case brought under the Market Abuse Regulation (Regulation 596/2014) (EU MAR).

112 https://www.fca.org.uk/publication/decision-notices/corrado-abbattista-2020.pdf.

113 https://www.fca.org.uk/news/press-releases/fca-confirms-permanent-restrictions-sale-cfds-and-cfd-options-retail-consumers.

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implemented to diagnose and prevent this kind of market manipulation, show that this focus is not limited to action brought across the pond. That said, the definition under English law as it currently stands is where it was in US law and practice some 10 years ago – namely that spoofing requires an intent to mislead. Some have asked whether updating the definition in the U.K. to mirror that in the United States would help the FCA to bring more spoofing cases, given only five such cases have been opened in the last two years – none of which appear to have been opened within the last 20 months.[114]

The definitional parameters are, however, unlikely to form the entire basis as to why the United States appears to be moving faster and harsher in this area than the U.K. The main reason is likely that historically, and in relation to spoofing, US penalties are extremely high, meaning actions brought tend to be concluded more quickly than they do in the U.K., so there are both definitional and cultural-regulatory reasons for these differences between the two countries. However, with no ultimate reference in the Abbattista case to the Upper Tribunal, answers to the question over whether we are going to see a copycat catch up from the U.K. with respect to spoofing, or rather, if the FCA will seek to forge a distinct regulatory path, remain to be borne out in future cases.

TFS-ICAP

Whilst the spoofing in Mr. Abbattista's case is one example of the type of systematic dissemination of misinformation against which the FCA is taking steps to enforce, another is trade printing, a practice that the regulator took action against in November. The regulator fined the FX options broker TFS-ICAP £3.44 million for "printing" trades and therefore communicating misleading information to clients.

The case centred on TFS-ICAP's behaviour between 2008 and 2015, where brokers were communicating to their clients that a trade had occurred at a particular price and/or quantity when no such trade had taken place. This trade printing activity sought to encourage clients to trade when they might not have done, in order to generate business for TFS-ICAP. Such open and prolonged activity was a breach in itself, however there was also evidence that TFS-ICAP failed to react to warning signs that such activity was taking place. Furthermore, the firm had deficiencies in its oversight and compliance arrangements to detect and counter the risk of brokers providing misleading information about trades to their clients. As such, TFS-ICAP not only failed to observe proper standards of market conduct (breaching Principle 5 of the FCA's Principles for Business), but also breached Principle 2 (a firm must conduct its business with due skill, care and diligence) and Principle 3 (a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems).[115]

A key takeaway from the case is that the culture of compliance at a firm is of great importance, echoing statements made by the FCA's Director of Market Oversight, Julia Hoggett (discussed in detail in the article on Market Abuse above), and in particular more recent comments from Jonathan Davison, the FCA's Executive Director of Supervision, on the fact that strong firm cultures are those "where a job is not just a job. A culture where all employees feel safe. Safe from retribution for speaking up."[116]

In this case, this activity was being openly practised over a prolonged period of time, and in apparently choosing to turn a blind eye and failing to supervise the desks concerned, the firm enabled the proliferation of printing as a "normal" trading strategy. Firms therefore need to ensure that not only are employees fully aware and trained on all relevant policies, but also that there is a no-tolerance approach to violations and rule breaches so that a culture of compliance is embedded and tested as operating effectively. It is also worth remembering that the sanctions in this case could have been far greater had these breaches occurred after the Senior Managers and Certification Regime (SMCR) was implemented, which has brought an increased focused from the FCA on personal liability for those in positions of seniority within firms.

A final point to note from this case was the fact that over and above the breaches of Principles, the supervisory investigation was complicated by the fact that there were no records to evidence this trade-printing practice. That said, the FCA was undeterred, despite these challenges, with Mark Steward, Executive Director of Enforcement and Market Oversight, stating: "This market should take notice that printing, or providing information to clients where the basis for the information is not true, is not in keeping with appropriate standards of market conduct. The market should also take notice that the opacity of such practices, while forensically challenging, is no bar

114 https://www.fca.org.uk/publication/foi/foi7123-response.pdf.

115 https://www.fca.org.uk/publication/final-notices/tfs-icap-2020.pdf.

116 https://www.fca.org.uk/news/speeches/business-social-purpose. See also the articles on Market Abuse, Changing of the Guard and Enforcement Trends for further discussion on the FCA's focus on culture.

to action either."[117] It is therefore clear that attempts by firms to obfuscate conduct breaches via poor record keeping will not offer them immunity from subsequent enforcement action.

Redcentric

June 2020 saw another major market abuse case when the FCA publicly censured Redcentric plc (an AIM listed firm) for issuing unaudited interim results in November 2015 and audited final year results in June 2016 which materially misstated its net debt position and overstated its true asset position in circumstances where it knew, or ought to have known, that the information was false or misleading.

The FCA decision to impose a public censure as its sole sanction, in spite of this breach of section 118 FSMA, is notable, given such behaviour would typically warrant a significant fine given the detrimental effect it had on purchasers of Redcentric shares during this period. As a result of its misleading financial statements, Redcentric's shares traded at a higher value than they should have done, and continued to do so until Recentric published its findings of misstated accounting balances in November 2017, a statement which saw the price of Redcentric's shares fall by approximately 52 percent during the course of that day. Furthermore, purchasers who had not sold those shares during this period suffered a loss as a result of the fall in price.

The FCA decided against further sanctions, however, chiefly in light of the Redcentric's swift implementation of a shareholder compensation scheme, and secondly because the FCA considered that such a fine would be against the broader public interest, as such a fine risked causing severe disruption to its customers, many of whom were National Health Service trusts, which were at that point in the midst of dealing with the COVID-19 pandemic. The FCA noted that Redcentric had cooperated well with it, and taken extensive steps to remedy its failings, including:

- Following discovery of the issues, Redcentric had swiftly commissioned an independent review.
- It proactively disclosed information to the FCA, and this voluntary cooperation led to a timely conclusion of the investigation, which was of great importance to the FCA.
- It corrected deficiencies in its systems and controls that had been ineffective to prevent the misconduct.
- By swiftly implementing a shareholder compensation scheme, it had taken all reasonable steps to compensate investors who suffered loss as a result of the incorrect financial statements.

It was this combination of factors that led the FCA to conclude Redcentric's resources would be best spent providing compensation to shareholders and continuing its services, rather than to pay a financial penalty. This also marks the first time that an AIM-listed company has offered to implement its own scheme to pay compensation to those affected by the harm it caused as a result of market abuse, and only the second such scheme since Tesco's investor compensation scheme in 2017.

This response from the FCA indicates that it will take a practical and holistic approach to enforcement where the circumstances of the wider climate and the sector in which the company operates mean that traditional penalties would not be in the public interest.
The question that remains is the extent to which circumstances surrounding the COVID-19 pandemic, and other public interest arguments, will continue to have the same effect. In any case, the FCA's positive response to Redcentric's devising and implementation of the compensation scheme, which it described as "exemplary", may have the effect of encouraging other companies to implement similar schemes when faced with an FCA investigation, in the hopes of securing the same mitigating effect or avoiding a financial penalty. That said, this case does not signal the end to FCA imposed fines; the regulator made it clear that a fine on Redcentric would have been appropriate, except for these special circumstances. Furthermore, in a separate action, the FCA has instituted criminal proceedings against three former employees of Redcentric, who appeared at Westminster Magistrates court on August 28, 2020 facing charges including making false or misleading statements, false accounting and fraud by false representation.[118]
Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA, said, "Publicly listed companies must ensure the market is properly informed with timely and true information ... Investors deserve to be told the truth and uncomfortable news cannot be hidden for very long."[119]

117 https://www.fca.org.uk/news/press-releases/fca-fines-tfs-icap-m.arket-misconduct.

118 https://www.fca.org.uk/news/press-releases/fca-institutes-criminal-proceedings-against-three-former-employees-redcentric-plc.

119 https://www.fca.org.uk/news/press-releases/fca-publicly-censures-redcentric-plc-market-abuse.

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Commerzbank

In June 2020, the FCA announced that it had imposed its second largest fine for anti-money laundering (AML) failings against the London Branch of Commerzbank AG. The firm was subject to a financial penalty of £37,805,400 for failures in AML systems and controls between October 2012 and September 2017.

The FCA found that Commerzbank breached Principle 3 by virtue of failings in a number of areas, including:

- Failing to conduct timely periodic due diligence on its clients, resulting in a significant backlog of clients that were overdue a KYC refresh.
- Failing to address long-standing weaknesses in its automated tool for monitoring money laundering risk, which – at one stage – was missing 40 high-risk countries and 1,100 high-risk clients.
- Failing to have adequate policies and procedures in place, which allowed an exceptions process to be misused so that the bank could continue to engage with clients even when KYC checks were overdue, and intermediaries' failures to adhere to policies regarding verifying beneficial ownership were allowed to continue unchecked.

The Final Notice indicates a number of key points to which firms would be well advised to pay close attention. Firstly, firms would be remiss not to take action where an issue has been highlighted by the regulator. In this case, the FCA had visited Commerzbank in 2012, 2015 and 2017 where various AML related issues were highlighted and discussed, and yet Commerzbank failed to take action to address these weaknesses. When considering penalties, this was an aggravating factor, particularly given Commerzbank AG had a "heightened awareness" of weaknesses in its global financial crimes controls due to a billion dollar settlement with US regulators in 2015.[120]

To that point, another key takeaway is that compliance does not take place in a vacuum, and the FCA expects that a global approach will need to be taken in many cases. In this case, both the FCA and the independent monitor appointed by the New York Department of Financial Services had raised specific concerns about Commerzbank London's financial crime controls in 2012, 2015, 2017 and 2018.[121] This was again an aggravating factor and the FCA's criticism of these continued failures makes it clear that the regulator expects firms to pay attention to lessons learned across jurisdictions, and that a strong compliance regime should function effectively across borders and business divisions.

Finally, and perhaps most importantly, is to note that in the Commerzbank case, this significant fine was imposed despite the fact that the FCA acknowledged that it found no evidence of the Commerzbank failings leading to any occurrences of financial crime taking place. This case therefore showcases that the FCA takes the *risk* of financial crime as seriously as the existence of the crime itself, so firms should not take comfort in an assumption that a weak AML system has not led to a crystallised incidence of financial crime. In this respect, FCA Executive Director of Enforcement and Market Oversight, Mark Steward, has stated, "Commerzbank London's failings over several years created a significant risk that financial and other crime might be undetected. Firms should recognise that AML controls are vitally important to the integrity of the U.K. financial system."[122]

Lloyds Banking Group plc

The need to act quickly once made aware of potential failings was also exemplified in another major case this year, which saw Lloyds Banking Group plc and two related entities (the "Banks") receive the largest fine imposed on a U.K. high street bank in the past five years.

In June, the FCA imposed a financial penalty of £91,495,400, discounted to £64,046,800, for breach of FCA principles, and this fine sat on top of a £300 million redress payment programme that the Banks are currently undertaking for 26,000 of its customers for unfair treatment.[123]

The FCA found that between April 2011 and December 2015, the Banks had breached both Principle 3 and Principle 6 of the FCA's Principles for Businesses when dealing with mortgage customers who were experiencing financial difficulties or were in mortgage arrears. Those principles are:

- Principle 3 – a firm must take reasonable care to organise and control its affairs responsibly with adequate risk management systems.

120 https://www.justice.gov/opa/pr/commerzbank-ag-admits-sanctions-and-bank-secrecy-violations-agrees-forfeit-563-million-and.

121 https://www.fca.org.uk/publication/final-notices/commerzbank-ag-2020.pdf.

122 https://www.fca.org.uk/news/press-releases/fca-fines-commerzbank-london-37805400-over-anti-money-laundering-failures.

123 https://www.fca.org.uk/publication/final-notices/lloyds-bank-plc-bank-of-scotland-plc-the-mortgage-business-plc-2020.pdf.

- Principle 6 – a firm must pay due regard to its customers' interests and ensure they are treated fairly.

Notably, some of these failings were identified by the Banks as early as 2011, but they failed to rectify them, meaning they were identified by the FCA as part of a thematic review conducted in 2013. To make matters worse, a further review by the FCA in July 2015 found that the Banks had still failed to make sufficient process in addressing the problems, despite Lloyds telling the regulator it was 'on track'[124] to implement the necessary improvement, and the Banks were required to undertake a Skilled Person's review.

A central takeaway from this case was that the Banks' systems, procedures and controls for gathering information were lacking, creating a risk that customers were treated unfairly. Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA, noted that "firms should take notice of the action we have taken today to ensure that their own treatment of customers meets our expectations".[125] From this, it is clear that a firm's duty to treat its customers fairly does not stop when a customer is in financial difficulties; rather, it becomes all the more important at such a time.

Furthermore, this case should serve as a reminder to firms of the risk of contesting a case before the RDC. Whilst the Banks accepted the FCA's findings of a breach, Lloyds brought the decision as to quantum before the RDC in a move that ultimately saw the Committee remove a 20 percent fine reduction that the FCA had been prepared to give. The clear conclusion here is that there is no such thing as a 'free shot' at reducing a financial penalty, and firms should carefully consider both the risk and the reward of such actions.

Barclays

The COVID-19 pandemic has seen the FCA issue statements showing that it is particularly concerned about the potential risk to vulnerable customers at this time.[126] However, this is not a new area of concern for the regulator, with protecting vulnerable customers listed as a key focus area in the FCA's most recent business plan.[127] One such case is that of Barclays,[128] which in December resulted in a financial penalty of £26,056,400 for breaches of Principles 3 and 6 of the Authority's Principles for Businesses and CONC 6.7.2R, 7.2.1R and 7.3.4R from its Consumer Credit sourcebook. This echoes a similar action brought against Lloyds (see above) for mistreatment of customers, with a similar theme of failing to show "forbearance and due consideration" to customers when they experienced financial difficulties.

Between April 2014 and December 2018, the FCA found that some retail and small business customers who has been offered consumer credit by Barclays were treated poorly when they fell into arrears, as it failed to follow its customers' contact policies for customers who fell into arrears; failed to have appropriate conversations with customers to help understand the reasons for the arrears; and failed to properly understand customers' circumstances leading it to offer unaffordable, or unsustainable, forbearance solutions.[129]

The FCA also identified that these failings were particularly serious because of the large number of customer accounts which were potentially affected, the vulnerable nature of these customers, which Barclays failed to properly identify, the fact that Barclays has committed to improving collections in 2015 but the failings continued into late 2018, and the fact that these failings were caused by serious systemic problems which Barclays failed to promptly identify and address. The breach was also aggravated by the fact that the Authority has imposed financial penalties on Barclays on at least seven previous occasions in relation to misconduct over the past decade.[130]

This case is notably given the sizeable financial penalty which was imposed, which itself was subject to a 30 percent reduction from £37,223,541 as a result of Barclays agreeing to settle. In addition, Barclays identified some 1.5 million customers who did or could have suffered detriment as a result of these breaches, and as such, has paid over £273,000,000 in redress to these customers.

124 https://www.ft.com/content/fd865bca-4aed-4b7b-9ecd-2ae7fa6c8223.

125 https://www.fca.org.uk/news/press-releases/fca-fines-lloyds-bank-bank-scotland-mortgage-business-failures-mortgage-arrears.

126 https://www.fca.org.uk/news/press-releases/new-guidance-help-firms-do-more-vulnerable-consumers.

127 https://www.fca.org.uk/publication/business-plans/business-plan-2020-21.pdf.

128 Barclays Bank UK PLC, Barclays Bank PLC and Clydesdale Financial Services Limited.

129 https://www.fca.org.uk/news/press-releases/fca-fines-barclays-treatment-customers-financial-difficulty.

130 https://www.fca.org.uk/publication/final-notices/barclays-2020.pdf.

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As evidenced by both this and the case involving Lloyds, the FCA remains focused on ensuring that customers experiencing financial difficulty are treated fairly and appropriately. Mark Steward, Executive Director of Enforcement and Market Oversight stated: "We will take action against unfair treatment, or where firm systems expose customers to the risk of unfairness. While this case predates the pandemic, this message is especially important as the impact of COVID-19 continues to affect household incomes and budgets".[131] To that point, the number of firms with customers facing financial difficulties is likely to have grown over the past 12 months, and the FCA has stated its recognition of the challenges that the current climate poses. However, it can also be expected that these prevailing financial conditions are likely to foster intense scrutiny over customer treatment by the regulator, and as such, firms must ensure that their systems and controls are properly managed in order to avoid facing similar enforcement action in future.

Asia Research and Capital Management Ltd

October 2020 saw another 'first' for the FCA, as well as a further reminder to firms of the need to act promptly once they are aware of issues. Asia Research and Capital Management Ltd (ARCM) received a fine of £873,118 for its failure to notify the FCA under the EU Short Selling Regulation (EU SSR) of net short positions it held in Premier Oil plc between February 2017 and July 2019, marking the FCA's first enforcement action for breaches of the EU SSR.

Under the EU SSR, net short positions in shares admitted to trading on a trading venue in the EU are notifiable to the relevant EU regulator when the position is equal to or exceeds 0.2 percent of the issuer's outstanding share capital, and at each 0.1 percent threshold above that. Public disclosures must also be made when the position is equal to or exceeds 0.5 percent and at each 0.1 percent threshold above that. During the relevant period, ARCM built a net short position of 16.85 percent of Premier Oil plc's issued share capital, representing "the largest net short position ever held in an issuer admitted to the Authority's Official List".[132] This position triggered over 300 notification and/or disclosure obligations – exemplifying how a single position can lead to multiple reporting failures – and was held for 106 trading days before it was finally notified to the FCA, in breach of Articles 5 and 6 of the EU SSR.

An important takeaway from this case was that this failed reporting obligation came as a result of a misunderstanding on the part of ARCM of the scope of the EU SSR. ARCM is not, and has never been, authorised by the FCA, and had "very infrequently taken short positions in companies in EU markets",[133] but had not taken steps to clarify its reporting obligations. Instead it had relied on third party materials that "included an indicative, rather than an exhaustive, list of the instruments to which the [EU] SSR applied", most importantly failing to state that derivatives trading fell within scope. This serves as a reminder, therefore, of the extra-territorial application of the EU SSR, and that traders on EU markets, as well as U.K. markets under the post-transition period incorporated legislation of the U.K. SSR, regardless of their location, must take adequate steps to ensure they are familiar with the specific U.K. (and EU) requirements that apply to such trading.

Another key practice point to note is that once again, delays in reporting these failures were considered to be an aggravating factor by the FCA. In this case, ARCM went through a process of "preparing the data and notification/disclosures required" and "instituted a process to ensure that the notifications/disclosures made were comprehensive and accurate, reflecting the full history of the position" before making the report.[134] The lesson to be learned here is that whilst providing full and accurate reports are important, this should not come at the price of prompt reporting to the regulator once it is apparent that a breach has occurred. Firms should also be mindful for their Principle 11 obligation to keep the regulator informed of anything of which it would reasonably expect notice.

Although the EU SSR has been in force since 2012, this is the first time that the FCA has taken enforcement action for breach of the Regulation. That should not be taken as a signal that such breaches are insignificant, however, which is a point that was driven home by Mark Steward, FCA's Director of Enforcement and Market Oversight, who noted: "Failure to report disclosable short positions undermines the integrity and efficiency of financial markets. ARCM repeatedly

131 https://www.fca.org.uk/news/press-releases/fca-fines-barclays-treatment-customers-financial-difficulty.

132 https://www.fca.org.uk/publication/final-notices/asia-research-and-capital-management-ltd-2020.pdf.

133 https://www.fca.org.uk/publication/final-notices/asia-research-and-capital-management-ltd-2020.pdf.

134 https://www.fca.org.uk/publication/final-notices/asia-research-and-capital-management-ltd-2020.pdf.

breached reporting rules and failed to provide important information to us and to the market. This fine reflects the seriousness of these breaches".[135]

This enforcement action should also be considered in the context of the lowered 0.1 percent threshold for reporting net short positions that was introduced by ESMA in March,[136] and extended once again in December.[137] As discussed in the article on Market Abuse above, ESMA has highlighted that the COVID-19 pandemic continues to constitute a serious threat to the orderly functioning and integrity of financial markets, which has had a particular impact on regulatory approaches to net short positions, which have the potential to exacerbate such market volatility. With the pandemic informing regulatory changes, and Brexit leading to slight nuances in process that kick in at the end of the transition period on December 31, 2020, firms must be well prepared to juggle various reporting requirements and keep abreast of changes so that they don't unintentionally miss a disclosure or notification obligation.

Carillion

A judgment at the end of last year saw the English courts answer the question as to whether the "liquidation stay" under the Insolvency Act 1986 ("IA 1986") could prevent the FCA from issuing a warning notice under sections 92 and 126 FSMA without first seeking leave from the court. The case saw the court faced with how it should tackle matters where these two statutory regimes come into conflict, with a question over which procedures should take priority.

In September 2020, the FCA gave Carillion plc (which has been in liquidation since 2018), and a number of its previous executive directors, a warning notice each in respect of various identified breaches.[138] The FCA stated that between July 2016 and July 2017, Carillion breached:

135 https://www.fca.org.uk/news/press-releases/fca-fines-arcm-breaches-short-selling-disclosure-rules.
136 https://www.esma.europa.eu/press-news/esma-news/esma-requires-net-short-position-holders-report-positions-01-and-above.
137 https://www.esma.europa.eu/press-news/esma-news/esma-renews-its-decision-requiring-net-short-position-holders-report-position-1.
138 https://www.fca.org.uk/publication/warning-notices/warning-notice-statement-20-2.pdf.

- Article 15 of EU MAR (prohibition of market manipulation) by disseminating information that gave false or misleading signals as to the value of its shares in circumstances where it ought to have known that the information was false or misleading.
- Listing Rule 1.3.3R (misleading information must not be published) by failing to take reasonable care to ensure that its announcements were not misleading, false or deceptive and did not omit anything likely to affect the import of the information.
- Listing Principle 1 (procedures, systems and controls) by failing to take reasonable steps to establish and maintain adequate procedures, systems and controls to enable it to comply with its obligations under the Listing Rules.
- Premium Listing Principle 2 (acting with integrity) by failing to act with integrity towards its holders and potential holders of its premium listed shares.

The FCA also considers that the relevant executive directors were knowingly concerned in the above breaches by Carillion.

Whilst the FCA only sought a public censure, not a financial penalty, the case still went before the English courts where it was determined that the FCA's decision to issue a warning notice did constitute an "action or proceeding" for the purpose of section 130(2) of IA 1986, and the FCA therefore required leave of the court before it could proceed against Carillion.[139] In this case, the court granted such permission on the condition that further leave should be obtained before any penalty was imposed by the FCA, following a recognition of the need to balance the competing interests of the two statutory regimes. The judge stated, "on the one hand there is the public interest and importance in ensuring the FCA can fulfil its statutory duties notwithstanding insolvency of a party concerned. On the other hand, the liquidation needs to be carried out, realisations distributed to creditors and the company dissolved. There is potential tension between the two statutory regimes."[140]

Therefore, whilst the FCA was not prevented from taking action against Carillion, the case sets an interesting precedent as it confirms that there are certain restrictions on the freedom of the FCA to execute its powers under FSMA. Whilst the decision is limited to the issue of notices under sections 92 and 126 of FSMA, which relates to issuing warning

139 https://www.bailii.org/ew/cases/EWHC/Ch/2020/2146.html.
140 https://www.bailii.org/ew/cases/EWHC/Ch/2020/2146.html.

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notices and decision notices where the FCA intends to impose sanctions under sections 91 and 123 of FSMA, the FCA is concerned about the wider implications. The regulator has some two hundred possible actions that it may take under FSMA, to which this decision could be applied by extension, and it seems likely that the issue of the liquidation stay in the context of regulatory action will be before the courts again in the future.

The case also poses interesting possibilities with regard to litigation privilege. The FCA has previously indicated that its investigation process does not become sufficiently adversarial to constitute "legal proceedings" until the issue of a Decision Notice by the RDC. This means that firms cannot avail themselves of the protection offered by section 413 of FSMA, which protects communication made in contemplation of and for the purpose of legal proceedings from disclosure to the FCA. However, the judge's reasoning in this case – whilst not explicitly concerned with the question of privilege or the adversarial nature of the RDC process – does lend weight to the argument that the RDC process constitutes legal proceedings. The court held that Parliament had intended that FCA Warning Notices should fall within the term 'action or proceeding', with the court's view that "the nature of the decision and the process applied by the Upper Tribunal, as by the FCA/RDC, "cries out" as a "proceeding".[141] Therefore, whilst the judgment noted that this case would affect the operation of the discretion to grant leave, not the construction of the word "proceedings", it would suggest that communications undertaken during an investigation where the RDC process is in contemplation – such as interviewing witnesses – may be able to benefit from litigation privilege. It remains to be seen whether any firm or individual will seek to run this argument in future, but the case shows that the decision raises questions not just for insolvency matters, but also the circumstances in which privilege is available.

141 https://www.bailii.org/ew/cases/EWHC/Ch/2020/2146.html.

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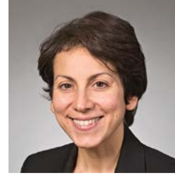

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