Katten

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DERIVATIVES

See "CFTC to Hold an Open Commission Meeting on January 30" in the CFTC section.

CFTC

CFTC to Hold an Open Commission Meeting on January 30

The Commodity Futures Trading Commission (CFTC) will hold an open meeting on January 30, from 9:00 a.m. to 12:30 p.m. ET, to discuss a proposed rule regarding position limits for derivatives. The meeting will resume at 1:30 p.m. to consider another proposed rule on amendments to codify current no-action relief regarding swap execution facility (SEF) and real-time reporting requirements.

The meeting is open to the public on a first-come, first-served basis, as well as via live webcast and conference call.

More information, including viewing and listening instructions, is available here.

BREXIT/UK DEVELOPMENTS

ESG and Sustainable Investments: House of Lords EU Committee Queries Taxonomy Regulation With HMT

On January 16, the House of Lords European Union Committee published a letter from the Chair, Lord Kinnoull, to John Glen, Economic Secretary to Her Majesty's Treasury (the Letter). The Letter concerns the recently published Taxonomy Regulation (for more information please see the January 10 edition of *Corporate & Financial Weekly Digest*).

In the Letter, Lord Kinnoull raises a number of questions regarding the Taxonomy Regulation. While some questions are procedural, most of the questions concern the interaction between the new regulation and Brexit.

One of Lord Kinnoull's questions is whether, post-Brexit, the UK Government will seek to align legislation produced in response to their Green Finance Strategy (available here) with the EU legislation produced in response to European Commission's (the Commission) Sustainable Finance Action Plan. The Taxonomy Regulation is one such piece of legislation.

Lord Kinnoull also observes that the Taxonomy Regulation represents a compromise between EU Member States regarding nuclear energy. Some Member States were in favor of designating nuclear energy as an "environmentally sustainable economic activity," but other countries did not support this view. Instead, nuclear energy is not mentioned in the Taxonomy Regulation but is expected to be designated a "transition activity" (i.e., an activity which supports the transition to a climate-neutral economy).

In the Letter, Lord Kinnoull notes, "the importance the [UK] Government attaches to the nuclear energy industry," and queries whether the UK Government intends to follow the EU's lead in this regard.

Finally, Lord Kinnoull turns to the Platform on Sustainable Finance. This group — to be chaired by the Commission and include scientists, policy-makers and private-sector stakeholders — will advise and assist the Commission in developing the delegated acts required by the Taxonomy Regulation. Lord Kinnoull queries whether the "proposed composition of the Platform . . . will allow the UK to maintain influence over the formulation" of the delegated acts following Brexit.

The Letter is available here.

FCA Publishes Dear CEO Letter for UK Alternative Investment Firms

On January 20, the Financial Conduct Authority (FCA) published a letter to the CEOs of UK-based alternative investment firms to outline the FCA's view of the key risks of harm to the customers or markets in which such firms operate (the Letter). The FCA defines alternative investment firms as firms that predominately manage alternative investment vehicles (such as hedge funds or private equity vehicles), or manage alternative assets directly, or provide advice on such vehicles or assets.

In the Letter, the FCA outlined the following supervisory priorities:

- **Investor exposure to inappropriate products or levels or investment risk**: The FCA intends to review retail investor exposure to alternative investment products, to ensure that firms are aware of who their customers are and that they are exposed to an appropriate amount of risk. (This may be a response to recent concerns about the promotion of mini-bonds to retail investors, which resulted in this temporary product intervention in November 2019);
- **Client money and custody asset controls**: Regarding the Client Assets Sourcebook (CASS), the FCA intends to review whether firms that have permission to hold client money and safeguard custody assets are doing so in a robust and CASS-compliant manner;
- **Market abuse**: The FCA noted that, despite recent work on market abuse controls (see, for example, this *Primary Market Bulletin*), there is still "significant scope for improvement," and therefore that more work may be conducted in the future;
- **Market integrity and disruption**: The FCA noted that alternative investment firms may adopt "very high-risk investment strategies," such as strategies with "significant leverage." If so, their risk management controls need to be "robust" enough to avoid "excessive risk-taking" and to mitigate "harm or disruption to financial markets;"
- **Anti-money laundering and anti-bribery and corruption**: The FCA is concerned that firms do not have "appropriate and proportionate systems and controls" to mitigate the risk that might "facilitate financial crime." Therefore the FCA intends to review the systems and controls of firms in this portfolio; and
- **EU withdrawal**: In the Letter, the FCA drew attention to their updated Brexit webpages (available here), and noted that firms should be preparing for the end of the implementation period, which is expected to be on January 1, 2021.

The Letter is available here.

FCA Publishes Dear CEO Letter for UK Asset Management Firms

On January 20, the Financial Conduct Authority (FCA) published a letter to the CEOs of asset management firms to outline their view of the key risks of harm to the customers or markets in which they operate (the Letter). The FCA defines asset management firms as firms that predominately manage mainstream investment vehicles, excluding wealth managers and financial advisers.

In the Letter, the FCA outlined the following supervisory priorities:

- **Liquidity management**: The FCA warned that "ensuring effective liquidity management in funds is a central responsibility for any Authorized Fund Manager (AFM)." (While not referencing it directly, this may be a response to the issues with the Woodford Equity Income Fund, which the FCA has previously addressed in

this letter and this policy statement. It also may be a response to recent concerns about the promotion of mini-bonds to retail investors, which resulted in this temporary product intervention);

- **Firms' governance**: The Senior Managers & Certification Regime (SM&CR) was expanded to asset managers on December 9, 2019 (for more information please see the December 13 edition of *Corporate & Financial Weekly Digest*). In the Letter, the FCA stated that work is planned "in the first half of 2020 to evaluate the effectiveness of governance across the sector," including the implementation of SM&CR;
- **Asset Management Market Study (AMMS) remedies**: The AMMS was published in 2017 (for more information please see the February 15 edition of *Corporate & Financial Weekly Digest*). One outcome of the AMMS was to require firms to conduct "value assessments." In the Letter, the FCA stated that work is planned for the first half of 2020 to determine if these assessments are being done effectively;
- **Product governance**: The FCA noted the product governance requirements introduced by the revised Markets in Financial Instruments Directive (MiFID II), and explained that work in early 2020 will assess how effectively these new product governance provisions have been implemented. They also will assess whether Authorized Corporate Directors (ACDs), to whom AFMs can delegate fund management responsibilities, are undertaking their responsibilities effectively;
- **LIBOR transition**: The FCA is generally concerned that firms are not preparing to stop using the London Inter-bank Offered Rate (LIBOR) by the start of 2022 (for more information please see the March 1 edition of *Corporate & Financial Weekly Digest*), and anticipate issuing "further communications on our specific expectations for LIBOR transition in due course;"
- **Operational resilience**: In the Letter, the FCA told asset management firms to expect more work on operational resilience in 2020 (for more information please see the January 17 edition of *Corporate & Financial Weekly Digest*); and
- **EU withdrawal**: In the Letter, the FCA drew attention to the updated Brexit website, and noted that firms should be preparing for the end of the implementation period on January 1, 2021.

The Letter is available here.

UK Withdrawal Agreement Becomes Law

On January 23, the European Union (Withdrawal Agreement) Bill became an Act of Parliament and is now legally binding in the UK. The purpose of this legislation is to give binding force to the withdrawal agreement that was made between the UK and the EU on October 19, 2019.

The next step will be for the withdrawal agreement to be ratified by the European Parliament, which is scheduled for January 29. If this vote is passed, the UK will leave the EU on January 31, 2020. The UK will then enter an 'implementation period,' during which all EU laws will continue to apply in the UK, while the UK and the EU negotiate their future relationship. This implementation period is scheduled to end on December 31.

EU DEVELOPMENTS

EFSA Comments on MiFID II Recalibration

On January 20, the European Forum of Securities Associations (EFSA) published a letter to the European Commission (the Commission) outlining the changes they would like to see to the Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR) (together, MiFID 2/R). This is in anticipation of the Commission's review of MiFID 2/R in July 2020.

In relation to market structure, EFSA set out the following "key issues":

- in general, the EU should make "the necessary equivalence determinations" and/or reduce the extraterritorial application of the rules, in order to "maintain the EU's attractiveness as a listing location for issuers;"
- regarding the share trading obligation (STO), the scope is too broad and that the rules disadvantage EU-based investment managers by encouraging investors to access liquidity outside of the EU;

- regarding the “tick size regime” for systematic internalizers (SIs), which requires EU trading venues to adopt a minimum increment for financial instruments depending on the liquidity and price, the current rules “inhibit appropriate price formation;”
- the status of SIs in the trade reporting hierarchies give them an unfair competitive advantage, and that there can otherwise be uncertainty about which counterparty should report. To resolve this, counterparties should be able to agree who will report; and
- the definition of SIs sometimes inappropriately applies to certain derivatives traders.

EFSA also have concerns about the following:

- data quality continues to be too low and, while EFSA supports a “properly constructed [consolidated tape], this would not resolve the “conceptual flaws” and “insufficient enforcement” of MiFID 2/R requirements;
- the rising cost of market data is a “significant issue,” and ESMA should address this by enforcing “existing regulatory requirements;”
- costs and charges disclosures should be “simplified and proportional,” and firms should be able to provide different disclosures to wholesale and retail clients;
- product governance rules are not proportionate and, in the context of ordinary shares and bonds, should be aligned with the primary market requirements;
- best execution requirements are creating “large volumes of unhelpful data,” and there is not enough clarity regarding the scope and format of the reporting; and
- as a result of the unbundling rules, there is less research being produced, especially concerning small- and medium-sized enterprises (for more information, please see the September 27 edition of *Corporate & Financial Weekly Digest*).

EFSA’s letter is available here.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.

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BREXIT/UK/EU DEVELOPMENTS

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