Regulatory update

January 18, 2021

Brexit briefly managed to dislodge COVID-19 from the headlines during the holiday period as the long-awaited end of the transition period was preceded on Christmas Eve by the Trade and Cooperation Agreement (**TCA**) between the EU and the UK. As anticipated, however, it contained little of substance on financial services. Our half-yearly regulatory update discusses this and related Brexit issues, as well as other important regulatory developments, including the key messages from the FCA's recent speech on culture in the Asset Management Sector, and the governmental and regulatory expectations of asset managers relating to ESG.

Brexit

The TCA says little about financial services beyond non-discrimination, free movement of capital, cooperation on cyber-security and rules on firms requiring authorization to provide services in respective territories: see our more detailed discussion here. The accompanying Joint Declaration on Financial Services Regulatory Cooperation between the EU and the UK, meantime, envisages a Memorandum of Understanding between the parties being concluded by March 2021 regarding the framework for "structured regulatory cooperation".

In other Brexit developments, on 22 December 2020 the FCA published the final Temporary Transitional Power directions. These mean that, for many purposes, firms and other regulated persons will not need to comply with changes to their UK regulatory obligations resulting from Brexit-onshored legislation immediately at the end of the transition period. Instead, from the FCA's perspective, firms may be able to continue to comply with regulation as it had effect before the end of the transition period for a limited time, until 31 March 2022.

On 9 November 2020, the Chancellor announced that the UK will be granting a package of equivalence decisions to the EEA states, including EU member states, across a number of financial services areas. The UK Government has legislated to ensure that UK businesses can continue to use clearing services provided by EU-based clearing houses. The Bank of England has published an interim list of third-country CCPs that, after the end of the transition period, can continue to be utilised for clearing services by UK firms under the temporary recognition regime.

Following the Commission’s announcement of a time-limited equivalence determination for the UK, ESMA has recognised the three UK-based CCPs as third-country CCPs until mid-2022. These UK CCPs can continue providing services in the EU after the end of the transition period.

FCA's focus on culture in the Asset Management Sector

In a recent speech at the Investment Association, the FCA discussed culture in the Asset Management Sector. Key messages were as follows:

I. Value Assessment

The FCA emphasised the importance of the value assessment, which was the centre-piece of the FCA's asset management market study (**AMMS**) remedies. The FCA hope that the industry will see this as an essential element of a firm's "corporate purpose", rather than a simple case of regulatory compliance.

The FCA view the value assessment as a firm’s opportunity to explain clearly to its staff and its customers what value its basic business proposition provides, and then to assess the extent to which it actually delivers that value. Where there is mismatch, the FCA expect firms to take action to improve the proposition they are offering to their customers.

II. Governance

The FCA emphasised that good governance does not stop at the governance remedies produced by the AMMS (such as the requirement for two independent directors on the AFM board, the value assessment, and the new prescribed responsibilities under the SMCR).

Firms should also address the connected priorities of regulated entity governance, and the appropriate management of conflicts of interest. This is especially the case in the typical asset management group structure because such a structure creates an inherent conflict of interest between the AFM which has an obligation to act in the best interests of investors, and the delegated investment manager from which services are being procured.

The FCA warned insufficient consideration to such conflicts is often embedded through heavily over-lapping AFM and investment manager boards, or the appointment of AFM board members with group roles and reporting lines that give them a direct interest in the revenue or profitability of the delegated investment manager.

III. Diversity and inclusion

The FCA has a continued focus on diversity and inclusion within firms, and believes that diversity in financial services firms, and an inclusive approach to that diversity, lead to better decision making, and in turn to a reduced risk of harm to consumers and market.

The FCA asked firms to consider how far has diversity and inclusion within the firm progressed from a discussion about staff to a discussion about customers, and the extent to which firms view their purpose in this way.

ESG focus

Recent developments setting out governmental and regulatory expectations of asset managers in respect of ESG should be firmly on firms' radars. We highlight the key developments below.

On Thursday 3 December we held our 'Investment and ESG: How are investors anticipating, measuring and managing their approach to ESG webinar'. Thank you to our panellists Aurelie Ratte, Angela Willetts and Jai Mallick who shared their real-life experience of how investors are measuring and managing their investment approach to ESG. For those of you who couldn't join, or who wish to listen again, please watch a recording of the webinar.

Interim Report and Roadmap for implementing mandatory climate-related disclosures by the TCFD as part of UK's green finance strategy

On 9 November 2020, the UK Government announced that it intends to make it mandatory for large companies and financial institutions across the UK economy to make climate-related disclosures aligned with the TCFD recommendations by 2025.

The FCA will consult in 2021 on measures that extend the current proposals for TCFD-aligned disclosures for client-focussed disclosures by asset managers.

Investment Association's report "Investing with purpose placing Stewardship at heart of sustainable growth"

The HM Treasury-led Asset Management Taskforce recently outlined a series of recommendations to place stewardship at the heart of an agenda to ‘build back better’ post-coronavirus. The recommendations connect investment decisions more closely with climate change and sustainability considerations, including:

- **Expanding stewardship beyond the traditional focus on equities**, so that investment managers can take a more active role as bondholders.
- **Strengthening escalation of stewardship** by providing guidance to investment managers on bringing forward their own resolutions when companies are not responding to their concerns, and asking Government to review the rules which govern shareholders’ ability to bring their own resolutions.
- **Embedding better stewardship in pension assets**, which represent 40% of the assets under management in the UK, by seeking Government support for the establishment of a Council of UK Pension Schemes to promote and facilitate high standards of pension stewardship.
- **Improving companies’ reporting and disclosure** including supporting the Government’s recent announcement to change company law to require all large UK incorporated companies to report in line with the TCFD.
- **Widening the adoption of the new UK Stewardship Code** beyond investment managers which are expected to be signatories, to all service providers involved in the investment process.

Recent FCA Speech "Building Trust in Sustainable Investments"

In a recent speech by Richard Monks, Director of Strategy at the FCA, at an industry panel discussion, the FCA made clear that it is considering whether to articulate a set of guiding principles to help firms with ESG product design and disclosure. The FCA have five areas for potential principles in mind:

1. **Consistency in messaging and approach:**
   A product's ESG focus should be clearly stated in its name, and then reflected consistently in its objectives, its investment strategy, and its holdings.
2. **A product's ESG focus should be clearly and fairly reflected in its objectives:**
   Where a product claims to target certain sustainability characteristics, or a real-world sustainability impact, its objectives should set these out in a clear and measurable way.
3. **A product's documented investment strategy should set out clearly how its sustainability objectives will be met:**
   This should include describing clearly any constraints on the investible universe. This includes any screening criteria and anticipated portfolio holdings. This should also include the fund's stewardship approach and actions the fund manager will take if investee companies are failing to make the desired progress.
4. **The firm should report on an ongoing basis its performance against its sustainability objectives:**
   This is about giving consumers the information they need to understand whether the stated objectives have been achieved in a quantifiable and measurable way.
5. **The firm should assure ESG data quality, understand their source and derivation, and articulate clearly and accessibly how it is used:**
   This includes the use of ESG ratings in the investment process.

Your Key Contacts

Craig Neilson
Partner, London
D +44 33 0222 1912
craig.neilson@dentons.com

Katharine Harle
Partner, London
D +44 20 7320 6573
M +44 7795 618213
katharine.harle@dentons.com

Celyn Armstrong
Partner, London
D +44 20 7246 7174
M +44 7917 751622
celyn.armstrong@dentons.com

Jaime O'Connell
Associate, London
D +44 20 7002 8521
M +44 7741 322973
jaime.o'connell@dentons.com