

KIRKLAND & ELLIS

Kirkland Alert

Summer Update on Recent UK and European Regulatory Developments

10 July 2020

We hope that all our clients, friends and their colleagues and families remain safe and well. In our last bulletin, we set out some of the key themes for the year ahead. In this *Alert*, we bring you up to date on some recent developments in those areas, as well as some new initiatives.

If you would like more detail on any of these issues, please do not hesitate to contact your usual Kirkland contact.

1. Brexit negotiations — equivalence in financial services

Since leaving the EU on 31 January 2020, the UK has been in a transition period (due to expire on 31 December 2020) during which time the UK continues to be treated as part of the EU's single market ("Transition Period"). This includes UK and EU firms having reciprocal rights of access under so-called single market directives (also known as "passporting").

Once the UK leaves the EU single market at the end of the Transition Period, UK firms will lose their "passports". Unless there is agreement from the EU recognising the UK's regulatory regime as "equivalent" to that of the EU in a specific area, UK firms will need to rely on national regulatory regimes (where discretion lies with individual EU member states) or establish licensed offices or put in place other arrangements within the EU to service their EU clients (the end of the Transition Period should not prevent EU clients requesting services from UK firms at their own initiative, on a "reverse solicitation" basis, as is currently the case for EU clients engaging firms outside the EU). As a result, the UK and the EU have been discussing possible equivalence arrangements that could come into force following the end of the Transition Period, including the UK's proposal for a legally enforceable regulatory cooperation framework.

On 30 June 2020, Michel Barnier, the EU's chief Brexit negotiator, said that the UK's proposals were not acceptable to the EU, as the proposals would severely limit the EU's regulatory and decision-making autonomy. The EU may still decide to grant UK firms market access under the EU's standard unilateral equivalence regime (as opposed to the model put forward in the UK's proposals), but it is doubtful whether all of these will be in place by the end of the Transition Period.

On 25 June 2020, the UK published its proposals to allow UK regulators to establish cooperation arrangements with the relevant regulatory authority or authorities for an EU member state and to take regulatory decisions concerning EU firms or products before the end of the Transition Period. Most, if not all, EU firms and products that currently benefit from passporting arrangements in the UK are expected to continue to do so under the UK's equivalence regime.

2. UK Senior Managers & Certification Regime (SMCR) — extension of certain deadlines

The SMCR has replaced the approved persons regime as the primary framework for personal conduct and accountability standards within the UK financial services sector. When first established, the SMCR covered only banks, insurers and systemically important investment firms but was extended with effect from 9 December 2019 to cover all authorised firms, including in particular those firms regulated only by the FCA such as investment advisers and fund and asset managers (referred to by the FCA as "FCA solo-regulated firms" in their SMCR publications).

On 30 June 2020, the FCA extended the deadline for FCA solo-regulated firms to undertake their first fitness and propriety assessments of Certified Staff from 9 December 2020 to 31 March 2021. The FCA's Conduct Rules for staff who are not Senior Managers or Certified Staff (as well as the requirement to submit data to the FCA for its directory of individuals) will also now apply from 31 March 2021.

The FCA has extended the deadline in order to give firms significantly impacted by the COVID-19 pandemic additional time to conduct fitness and propriety assessments and comply with the other requirements. The FCA has nonetheless advised firms to continue with their programmes of work in the above areas, and to complete certifications earlier than March 2021 where they are able to do so. The FCA has further noted that firms should not wait to remove staff who are not fit and proper from their certified roles.

3. ESG

EU initiatives on ESG are continuing to progress. Recent developments include:

- the publication of the Taxonomy Regulation in the Official Journal (22 June 2020). The EU has developed the Taxonomy Regulation to support the development of a common language and uniform criteria to identify the extent to which economic activities may be considered environmentally sustainable;
- the beginning of a consultation by the European Supervisory Authorities (“ESAs”) on the regulatory technical standards on the ESG disclosure requirements under the Disclosure Regulation (23 April 2020). The Disclosure Regulation imposes new obligations on financial market participants and financial advisers (including fund managers and relevant investment firms); its requirements include more transparency on how ESG risks are integrated into investment decision-making or advisory processes and increased disclosure for financial products that target sustainable investment objectives or promote environmental characteristics. The ESAs’ consultation relates to the content, methodologies and presentation of the required disclosures; and
- the publication of draft changes to (among others) MiFID II and AIFMD, which would integrate sustainability considerations into firms’ organisations, operations, risk management processes, etc.

Over the course of this summer, firms should think about their approach to ESG matters, develop their awareness of the new EU ESG rules and consider putting ESG planning updates on their compliance agenda.

4. Revisions to European Market Infrastructure Regulation (“EMIR”)

As of 18 June 2020, Financial Counterparties (such as banks) are solely responsible for the reporting of OTC derivatives transactions entered into with certain Non-Financial Counterparties under EMIR. Buy-side Financial Counterparties, such as funds managed from the EU, will be required to continue reporting OTC derivatives transactions.

Previously, all EU counterparties (whether Financial or Non-Financial) were generally required to report OTC derivatives transactions. However, as of the above date, the obligation to make the relevant report is that of the Financial Counterparty alone, in certain circumstances.

Non-Financial Counterparties (such as under-fund EU SPVs that only use derivatives for hedging) that do not exceed the EMIR clearing thresholds no longer need to independently report OTC derivatives transactions entered into with Financial Counterparties in the EU – this now being the obligation of the Financial Counterparty only.

5. FCA expectations in relation to MAR as a result of COVID-19 Crisis

In May 2020, the FCA published its market conduct newsletter that focused on the FCA's expectations in the context of the COVID-19 pandemic (see FCA Market Watch 63).

The FCA drew attention to the increased capital-raising events taking place and the risks associated with alternative working arrangements. In this context, the FCA emphasised the importance of firms having the right controls in place regarding inside information and encouraged particular focus on several areas including appropriate identification and handling of inside information, robust surveillance and suspicious transaction reporting, identification and management of conflicts of interest and compliance with short selling regulations. The FCA emphasised its continued focus on monitoring, investigating and enforcement in these areas.

6. New Swiss Marketing Regime

On 1 January 2020, new rules for marketing private funds to investors in Switzerland came into force. Until the end of 2021, managers can choose whether to market funds under transitional rules (broadly the same rules as in 2019) or move to marketing under the new rules. However, there are some requirements that will apply to all managers marketing funds in Switzerland starting from late 2020.

Managers may choose to market under the new rules because, unlike under the previous regime, the circumstances in which they must appoint a Swiss Representative and Paying Agent are more limited – broadly, only when marketing to high-net-worth investors.

Moving to the new rules may also allow managers to dismiss Swiss Representatives and Paying Agents for *existing funds*. However, when marketing under the new rules, managers will need to comply with new conduct and organisational requirements (subject to the option for certain investors to opt out of some of these requirements).

All managers marketing to investors in Switzerland (including those who do not market under the new rules) must register with an ombudsman in Switzerland by 24 December 2020. Similarly, by 20 January 2021, all managers must consider whether they need to register staff marketing funds in Switzerland on a register of "client advisers" or if an exemption is available.

7. FCA discussion paper on the UK prudential regime for MIFID investment firms

As we covered in our earlier *Alert*, the EU Investment Firms Regulation and Directive (“IFR” and “IFD”, respectively) came into force on 25 December 2019, with most of the requirements due to apply to MIFID investment firms from 26 June 2021. While the UK has exited the EU, the UK Government and the FCA have both stated their intentions to put in place a prudential regime that mirrors the IFR/IFD, for UK investment firms authorised under MIFID II.

As a reminder, IFR/IFD is introducing certain fundamental changes to the prudential rules applicable to firms falling within its scope, which would include UK-based investment advisory and management firms authorised under MiFID II. The rules will apply to such firms depending on whether they are classified as “investment firms” (in which case a baseline set of requirements apply), or “small and non-interconnected investment firms” (in which case, a subset of such requirements will apply).

Amongst other matters, the baseline changes applicable to “investment firms” include (i) the introduction of a new framework for the calculation of regulatory capital (which, for certain kinds of MIFID firms, could potentially result in a significant increase in minimum regulatory capital requirements); (ii) new liquidity requirements; (iii) internal capital adequacy assessment requirements; (iv) enhanced regulatory reporting and public disclosure requirements; and (v) remuneration requirements, which include maintaining an “appropriate ratio” between fixed and variable remuneration; paying out at least 50% of variable remuneration in certain instruments; deferring at least 40% of variable remuneration over a 3–5 year period, and implementing malus and clawback provisions in remuneration structures to help protect a firm’s regulatory capital in the event of financial distress.

On 23 June 2020, the FCA published a discussion paper setting out the FCA’s interpretations and views on key features of the IFD/IFR regime, including the topics highlighted above, which will form the basis for the new prudential regime applicable to UK MIFID investment firms.

The FCA has requested comments and responses to the discussion paper by 25 September 2020, and has noted its intentions to publish a consultation paper later in 2020. Over the course of this summer, firms should assess how they will be classified under the IFR/IFD, and ahead of the FCA publishing its consultation paper, familiarise themselves with the corresponding requirements under the new rules, and consider at a high level the potential impact to their governance and compliance arrangements.

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Related Services

Practices

- Transactional
- Investment Funds

Suggested Reading

- 23 July 2020 Kirkland Seminar Navigating Private Fund Valuations During COVID-19
- 09 July 2020 Speaking Engagement Uncharted Waters: Navigating Advisory Office Re-Entry
- 09 July 2020 Press Release Kirkland Advises ParkerGale and Accel-KKR In Backing ATP's Acquisition of Flightdocs

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