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Wealth and Asset Management Regulatory Guide

2019

Update on key timings and trends

Your guide to critical regulatory milestones, analysis of hot topics and emerging regulatory trends

Climate change risk

There is accelerating regulatory focus on managing the financial risks from climate change. Since the Paris Agreement in December 2015, 106 laws and policies have been introduced worldwide.

The PRA was the first regulator to set standards for climate risk management. Policy Statement 11/19 was released in April 2019 requiring banks and insurers to take a strategic approach to "managing the financial risks from climate change, taking into account current risks, those that can plausibly arise in the future, and identifying the actions required today to mitigate current and future financial risks." In addition it sets expectations in a number of areas including governance, risk management, scenario analysis, and disclosures. Firms are required to have initial plans and updated senior management function (SMF) forms in place by October 15th 2019. The policy set out in PS11/19 has been designed in the context of the existing UK and EU regulatory framework and will not be affected in the event that UK leaves the EU with no implementation period in place.

In June 2019, the European Commission published guidelines on reporting climate change-related information under the Non-Financial Reporting Directive 2014/95/EU. The guidelines are a part of the Commission's Sustainable Finance Action Plan published in March 2018 that aims to reorient capital toward sustainable investment, manage financial risks arising from climate change, and foster transparency and a long-term view in financial and economic activities. The guidelines list criteria for 67 economic activities and establish standards on taxonomy, EU green bonds, and benchmarks.

Overall, we are seeing momentum building among policy makers, investors, banks, insurers and companies in the real economy – both in the UK and across the globe. Investment managers are making strong progress on addressing climate change in a variety of investment areas to mitigate risks to their portfolio.

Climate change is prompting a growing trend among firms to move to assets that are resilient to climate risk, as the increasing physical and transitional risks can lead to a surge in insurance premiums, higher capital expenditure and operational costs. Investment managers are using a holistic approach to assessing climate change risk to construct global portfolios, allowing them to make better decisions and rebalance exposures.

We advise that Investment managers act now to understand and prepare for the uncertain impacts of climate change by developing comprehensive strategies and implementation plans to enhance their strategic resilience.

Liquidity issues

The size of the largest assessment management firms has increased dramatically in the last decade, as restrictions on bank leverage and capital have shifted capital provision to non-bank financial institutions.

Despite investing cash rather than borrowed money, asset managers still face liquidity risks via redemptions from underlying investors. The risk caused by less liquid underlying assets has led to several high-profile funds temporarily shutting to new redemptions. As Bank of England Governor Mark Carney bluntly put it to MPs last month, "these funds are built on a lie." You can't have daily liquidity for funds that invest in assets that fundamentally aren't liquid.

We saw this in June with the outflows from H2O and the gating of Neil Woodford's equity funds. Much of Woodford's funds were invested in highly illiquid investments and Woodford had pushed the limit of the regulations by listing private investments on small exchanges to keep below regulatory thresholds.

So what will regulators do? Mark Carney has been very clear that he wants asset managers to take liquidity far more seriously. He believes that investors should expect terms that are in line with the liquidity of the assets. In addition, FCA head David Bailey has said UCITS are contributing to the problem by allowing stocks to be considered as listed without being actively traded. Given that many retail investors have been hit by Woodford, we expect to see increased regulatory scrutiny in this area.

Operational resilience

On 5th June 2018 the Prudential Regulation Authority (PRA), Financial Conduct Authority (FCA) and Bank of England issued a joint discussion paper on operational resilience, highlighting the increased regulatory focus.

The authorities are expected to publish a consultation paper in Q4 this year, reaffirming their approach to resilience and providing some further clarity on some of the key principles outlined in the discussion paper. However, the authorities are already holding some firms to the standards set out in the discussion paper, and European and US regulators are also exploring a similar direction. Asset and Wealth Management firms therefore need to start responding to this now, if they haven't already.

But what does being resilient really mean, and how should organisations respond? We believe that operational resilience cannot be achieved in isolation, and is a factor of existing capabilities across the organisation. These capabilities need to work in concert to allow an organisation to offer resilient services to its customers and other interested parties.

Key areas of focus are:

- Ensure clear ownership and accountability for operational resilience, which includes understanding the critical people, processes and systems that underpin a resilient service. The Board should actively weigh up the costs of operational failures against the financial cost of being resilient.
- Design operational processes and locations to support resilience during disruption. This includes areas such as Incident and crisis management, and business continuity planning.
- Manage Business and IT change in a way that supports resilient outcomes and resilience is a standard part of the change process.
- Ensure technology systems, processes, data and infrastructure are sufficiently resilient to maintain service during disruption, and support fast and effective recovery.
- Put adequate Information Security capabilities in place to protect against adverse cyber security events.

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- Understand and manage resilience risk relating to third-party suppliers and partners, with suppliers assessed on how they manage risk at the point of selection as well as on an on-going basis.
- Put in place an organisational culture that values behaviours supporting resilient outcomes, and people with sufficient skills and knowledge to maintain resilience.

We are working with firms on all aspects of their resilience framework, and helping them respond to some of the specific requirements in the discussion paper, including helping them think through how to define and prioritise services and calibrate their impact tolerances.

SMCR

With weeks remaining, firms' biggest risk is implementing SMCR as a tick box exercise. While this will help firms meet the December 2019 deadline, it won't necessarily drive the cultural shifts and changes in mindset that the FCA intended with the regime.

In this context, based on our experience with banks, firms still have time to consider the following key items:

- Effective BAU implementation – poor implementation could lead to remediation work to be able to run the regime in BAU. Firms should agree BAU roles and responsibilities as SMCR compliance continues beyond the implementation date. They should also consider how the framework aligns with their governance structure
- Senior managers' sensitivities –Senior Managers need to feel comfortable with requirements to evidence reasonable steps. Senior Managers also need reasonable assurance that other areas are doing their job, eg through a dashboard / review process. Firms will need to provide ongoing support to individuals directly affected including providing appropriate tools, an ongoing learning and development

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- Embedding SMCR behaviours – firms may prioritise Senior Managers regime implementation given the individual implications and sensitivities, and tackle the certification regime and conduct rules as a tick box exercise. By doing so, firms might struggle to embed culture change and accountability throughout the firm. This could be done through:
  - Leadership and role modelling
  - Engaging employees in the culture change programme to develop clarity about what is expected of them
  - Deliver a comprehensive tailored training and coaching curriculum

The EU Cybersecurity Act

On the 27 June, ENISA, the EU Agency for cyber security adopted its new mandate under the European Cybersecurity Act. The Act, further increases the important role that ENISA plays in both ensuring effective cybersecurity across the EU and driving innovation and co-operation. Under its new mandate ENISA will be developing a Cybersecurity Certification Framework aimed at ICT products and services, ultimately addressing two distinct challenges affecting industries today:

1. The emergence of different cyber security certification schemes that do not align to any overarching framework and therefore struggle to be sustained or valued in the market, and;

2. The lack of support and governance to ensure strong coverage of cyber security requirements across multiple industries, whether it's supporting smaller SMEs that provide ICT products and services to large organisations, or the security of IoT affecting critical national infrastructure.

Organisations should keep a close eye on the development of this framework and seek to embed this change within their vendor management and risk assessment frameworks.

IBOR

The rate often described as the "world's most important number" is set to disappear. Following the much publicised LIBOR rigging scandal and concerns about the volume of underlying transactions for IBORs, regulators announced that banks would no longer be compelled to submit LIBOR data post 2021. The importance of this should not be underestimated - IBORs are systemically important, having been referenced in trillions of contracts across complex financial instruments as well as consumer products for decades. Alternative rates have been identified, but they are structurally different, meaning that the switch goes beyond a one-for-one administrative change. Given this, there is no one size fits all approach to the transition and firms must set up programmes now. The effort required is dependent on the organisation's size, scale and geographic footprint, and organisations must be flexible to respond to the latest market developments. The impact is likely to be multi-faceted and touch all parts of the organisation. We feel that the major impacts will be on updating curves and models, managing changes in valuations, risk measurements, hedging, the balance sheet and more. It is also important to look back when assessing the impacts. A large number of contracts that reference IBOR extend beyond 2021 and renegotiation is likely to be costly and resource intensive. Compounding this issue is that fact that fallback provisions are mostly inadequate and do not often envisage a situation where IBORs are permanently discontinued.

As well as financial risk, organisations must also be able to identify and mitigate legal, conduct and reputational risks associated with selling IBOR-linked products, knowing that IBORs will no longer be available throughout the life of the contract. Given all these changes, client and internal education is hugely important. With a 2021 deadline and several industry unknowns, it is tempting to kick the issue into the long grass. However, given the complexity of the transition and increasing liquidity in products that alternative rates with associated market share implications, this would be unwise.

About Baringa Partners

Baringa Partners is an independent business and technology consultancy. We help businesses run more effectively, navigate industry shifts and reach new markets.

We use our industry insights, ideas and pragmatism to help each client improve their business.

Collaboration is central to our strategy and culture ensuring we attract the brightest and the best. And it's why clients love working with us.

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Baringa's Finance, Risk and Compliance Team

Baringa's Finance, Risk and Compliance Team specialises in helping firms understand and respond to the strategic, financial and operational implications of new regulation and to enhance risk management. A trusted advisor to risk, compliance and treasury leaders, Baringa Partners' capabilities and credentials span banking, insurance, asset management, capital markets, commodities and wholesale energy.

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Wealth and Asset Management Regulatory Developments Tracker 2019

The timelines reflect a number of key regulatory themes in the shape of both guidance and requirements that will be affecting the wealth and asset management sector in 2019 and looking forward to 2020. It is important that firms consider the potential impacts on their business. The timeline covers themes such as the Asset Management Market Study, Operational Resilience, liquidity and leverage risks, SFTR and climate change.

Baringa's Finance, Risk and Compliance team specialises in helping firms understand and navigate the spectrum of regulatory milestones and challenges as well as provide insight and solutions addressing key industry trends. We are unique in our ability to bring together these skills within a single team, combining capabilities to bring the very best advisory and delivery services to our clients.

Abbreviations

AIFMD	Alternative Investment Fund Managers Directive
AIF	Alternative Investment Funds
AMLD V	Anti-Money Laundering Directive V
BCBS	Basel Committee on Banking Supervision
BoE	Bank of England
CCP	Central Counterparty
CDS	Credit Default Swaps
CMA	Competition & Markets Authority
CRD/R	Capital Requirements Directive/Regulation
CRS	Common Reporting Standards
CSD	Central Securities Depository
CSDR	Central Securities Depository Regulation
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EEA	European Economic Area
EMIR	European Market Infrastructure Regulation
ESAs	European Supervisory Authorities
ESG	Environmental, Social and Governance
ESMA	European Securities and Markets Authority
ESTER	Euro Short-Term Rate
EU	European Union
FAMR	Financial Advice Market Review
FCA	Financial Conduct Authority
FSB	Financial Stability Board
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act
FRTB	Fundamental Review of the Trading Book
GSIB	Global Systemically Important Bank
HMRC	Her Majesty's Revenue & Customs
HMT	Her Majesty's Treasury
IBOR	Inter Bank Offered Rate
ICO	Information Commissioner's Office
ICT	Information and Communications Technology
IOSCO	International Organisation of Securities Commissions
LCR	Liquidity Coverage Ratio
LIBOR	London Inter-Bank Offered Rate
MAD/R	Market Abuse Directive/Regulation
MiFID/R	Markets in Financial Instruments Directive/Regulation
OTFs	Organised Trading Facilities
PRA	Prudential Regulatory Authority
PRIIPS	Packaged Retail Investment Products
PSD II	Payment Service Directive II
RTS	Regulatory Technical Standards
SI	Systematic Internaliser
SFTR	Securities Financing Transactions Regulation
SM&CR	Senior Managers and Certification Regime
SONIA	Sterling Overnight Index Average
SSM	Single Supervisory Mechanism
TCFD	Task Force on Climate-related Financial Disclosures
UCITS	Undertaking for Collective Investments in Transferable Securities

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Theme	Sub-theme	Regulation	JAN – DEC 2019, 2020+
Financial Regulation	**Brexit**	▲ UK exits EU	**31.10.19:** UK exits the EU (in case of no extension agreed by EU27 members) **Sep 2021:** Basel Committee and IOSCO have extended the timeline by a year new requirements for non-cleared derivative margin
	EU / Global	▲ AMLD V	**Q4 2019:** Adoption of the ICS Version 2.0 is expected at the IAIS's 2019 Annual Conference **10.01.20:** Directive will come into force, bringing virtual currency exchanges and custodian wallet providers into it
	Capital	▲ CRD V / CRR II	**Q2 2019:** Earliest likely date for a political agreement by EU institutions on the Level 1 text of the CRD V/CRR II package **Q2-3 2019:** Earliest likely date for secondary rulemaking to begin following a political agreement by EU institutions on a Level 1 text for the CRD V/CRR II package
	Securities	▲ SFTR	**Q3 2019:** FCA rules on publication of value for money assessments are expected to come into force **Q3 2019:** New prescribed responsibility for fund governance under SM&CR is expected to become applicable **Q2 2020:** Application of reporting requirements for credit institutions and investment firms **Q3 2020:** Application of reporting requirements for central securities depositories and central counterparties **Q4 2020:** Application of reporting requirements for insurers and investment funds **Q1 2021:** Application of reporting requirements for non-financial counterparties
Market Structure	**Investment Management**	▲ AIFMD ▲ Asset Management Market Study ▲ Automated Advice ▲ Closet Indexing ▲ Liquidity and leverage risks in investment funds ▲ PRIIPS ▲ Fund Performance Fees	**Q1 2019:** EC is expected to launch a consultation on the review of AIFMD **Q1 2019:** FCA expected to publish a policy statement on its second set of measures **Q1 2019:** FCA is expected to publish a policy statement on remedies on investor disclosures, following its asset management market study **Q1 2019:** CMA is expected to publish its final decision on its Investment Consultants Market Investigation **Q1 2019:** FCA is expected to feedback on its outcomes testing on automated advice **Q1 2019:** ESMA is expected to publish a report on the work done at national level to address closet-indexing **Q1 2019:** ESAs are expected to submit RTS to the Commission setting out targeted amendments to PRIIPs rules **Q1 2019:** FCA is expected to publish a feedback statement on its call for input **Q1 2019:** ESMA is expected to publish guidance on performance fees for investment funds **Q1-Q4 2019:** IOSCO is expected to publish a final report on leverage measures for investment funds **Q1-Q4 2019:** ESMA is expected to publish guidance on fund liquidity stress testing **Q1-Q4 2019:** FCA is expected to publish a policy statement on illiquid assets and open-ended funds **Q1-Q4 2019:** ESMA is expected to publish guidance on fund leverage limits under the AIFMD **Q1-Q4 2019:** FCA is expected to publish a policy statement on illiquid assets and open-ended funds **Q1-Q4 2019:** EC is expected to propose legislation on fund liquidity management and reporting of liquidity and leverage risks **Q4 2019:** EBA is expected to publish a report/opinion on regulatory technologies **Q4 2019:** UK government's Fintech Delivery Panel will publish a set of industry standards that will support Fintech firms by providing them with a consistent understanding of what financial services firms will need from them before entering into partnership arrangements
	Disruption and innovation	▲ Fintech ▲ Regtech ▲ Crowdfunding	**Q1 2019:** ESAs will explore the need for guidelines on outsourcing to cloud service providers **Q1 2019:** EU Commission is expected to publish a report on best practices for regulatory sandboxes **Q2 2019:** FCA will publish its finalised rules on crowdfunding, to address areas of concern, especially for loan-based crowdfunding **Q2 2019:** EU Commission Expert Group will asses unjustified regulatory obstacles to financial innovation, and whether the current regulatory framework fosters financial innovation and the scaling up of innovative start-ups **Q2-Q4 2019:** EBA is expected to report on emerging technology risk and give guidance for prudential supervisors **Q4 2019:** EBA is expected to publish Guidelines on ICT and security management, including expectations on resilience testing
	Cyber Resilience	▲ Operational Resilience ▲ IT Risk	**Q1 2019:** EBA is expected to publish guidelines on IT management and security for regulated entities **Q1 2019:** EBA is expected to publish a report/opinion on legislative improvements for IT management and security **Q1-Q3 2019:** BoE and PRA are expected to publish further details on the upcoming Cyber and operational resilience stress-testing pilot approach **Q1-Q4 2019:** ECB is expected to publish maturity-based expectations for Cyber and operational resilience of SSM banks **Q1-Q4 2019:** G7 expected to publish a statement on cyber-risk red team testing **01.03.19:** Updated liquidity assessment for equities to be published **09.05.19:** Category 4 firms subject to clearing obligation for CDS **21.06.19:** Category 3 firms subject to clearing obligation for CDS **01.09.19:** Initial margin requirements for firms exceeding the EUR 750 bn threshold to be phased-in **01.09.20:** End of phase-in for initial margin **Q4 2021:** FCA announced that by end-2021 they would no longer seek to compel or persuade panel banks to submit LIBOR quotes
	Trading	▲ EMIR ▲ IBOR Reform ▲ MiFID II	**Q1 2019:** FCA is expected to feed back on the results of its multi-firm review on payment for research **Q1 2019-Q4 2020:** Euro risk free rates working group is expected to develop and launch a Euro risk free rate term structure **Q1 2019:** FCA will publish an occasional paper on the savings adequacy of the UK population **30.04.19:** Updated transitional transparency calculations for derivatives, exchange-traded-commodities and exchange-traded notes, structured finance products and emission allowances, large in scale and size specific to the financial instrument thresholds for bonds to be published **Q2 2019:** First legislative proposal to amend EMIR is expected to be finalised in the first half of 2019 **Q2 2019:** CCP supervision proposal is expected to be finalised in the first half of 2019 **Q2 2019:** Euro risk free rates working group is expected to provide recommendations on contract, protocol and regulatory amendments **Q2-Q4 2019:** A term SONIA term rate is expected to be available **03.07.19:** Open-access requirements for exchange traded derivatives to apply to several major trading venues previously exempted **Q3 2019:** Expected start date of the SONIA term rate daily publication **Q4 2019:** Daily publication of ESTER is expected to start
	Pensions	▲ Pensions & Retirement outcomes	**Q2 2019:** UK ICO will launch the trial phase of its sandbox focused on data protection
	Payments	▲ PSD II	**Q1-Q2 2019:** FCA to publish an updated Memorandum of Understanding with the ICO on how they will work together in the future
Conduct	**Financial Inclusion**	▲ Big Data	**Q1-Q4 2019:** EBA is expected to publish a report on financial exclusion and big data **01.01.20:** Transitional arrangements for certain benchmarks will expire
	EU / Global	▲ EU Benchmarks Regulation	**Q2-Q4 2019:** FCA has stated it expects the SM&CR regime will commence from mid-to-late 2019
	UK	▲ FAMR ▲ Investment Platforms Market Study ▲ SMCR ▲ Wholesale Conduct	**Q1 2019:** FCA is expected to publish a final report on its investment platforms market study **Q1 2019:** FCA will publish a report for consultation on its approach to market integrity **Q1-Q4 2019:** FCA and HMT will conduct a review of the outcomes from FAMR **01.04.19:** FCA price cap on rent-to-own products is expected to come into force pending a consultation
	Consumer Vulnerability	▲ Vulnerable customers	**Q1 2019:** FCA is expected to publish new guidance on vulnerable consumers **Q1-Q2 2019:** Treasury Committee is expected to report on its inquiry into the level of access consumers have to financial services, with a particular focus on vulnerable customers
	Sustainable Finance	▲ Climate Change ▲ Green Bonds ▲ Credit Rating ▲ Sustainability Ratings ▲ Corporate Governance ▲ TCFD report	**Q1 2019:** EC technical expert group is expected to provide an EU classification system for climate change mitigation activities **Q1 2019:** ESAs are expected to collect evidence of undue short-term pressure from capital markets on corporations **Q1 2019:** FCA expected to consult on how workplace personal pension schemes consider ESG and climate change risks and opportunities and relevant non-financial factors **Q1 2019:** PRA is expected to publish its supervisory statement on the management of financial risks from climate change **Q1-Q2 2019:** EC is considering incorporating climate risks into firms' risk management policies and potential calibration of banks' capital requirements under CRR/CDR **Q2 2019:** EC technical expert group is expected to report on an EU standard for green bonds **Q2 2019:** A delegated act on the content of the prospectus for green bond issuance is expected **Q2 2019:** EC technical expert group is expected to report on the design and methodology of the low-carbon benchmark **Q2 2019:** ESMA is expected to assess practices in the credit rating market and to include ESG information in its guidelines on disclosure for credit rating agencies **Q2 2019:** EC is expected to carry out a study on sustainability ratings and market research **Q2 2019:** Expected revision of guidelines for companies on how to disclose non-financial information in relation to climate-related data **Q2 2019:** EC is expected to assess potential measures to promote corporate governance more conducive to sustainable finance **Q2 2019:** TCFD expected to publish an updated report to the FSB **Q3 2019:** EC to report on progress made on actions involving credit rating agencies **Q3 2019:** EU classification system for climate change and sustainable activities is expected to come into effect **Q3 2019:** TCFD expected to publish a report on implementation progress **Q3 2019:** PRA is expected to publish a report and survey results on the UK banking sector's response to climate-related financial risks