DUFF & PHELPS

REGULATORY **FOCUS**

A synopsis of the Financial Conduct Authority's (FCA) latest news and publications issued in March 2018.

ISSUE 113

Firms will have spent the last month preparing for looming deadlines which present new obstacles as we step into previously untrodden territory.

- RTS 28 disclosures required under MiFID II are due by 30 April 2018 where relevant (e.g. for firms that execute or transmit orders). If firms would like guidance on this, we encourage them to get in touch.
- GDPR will come into force on 25 May 2018, only one month from now. We would like to remind our readers that Duff & Phelps have developed a GDPR toolkit and to contact us if they would like assistance with this.

The regulator has also been proactive in March and early April. There are currently a number of consultations open for comment.

- The FCA is consulting on changes to the Financial Crime Guide (FCG) for firms. A new chapter on insider dealing and market manipulation has been included into the FCG. This includes examples of good and bad practice and gives firms self-assessment questions to consider when undertaking their market abuse risk assessment. This consultation is open until 28 June 2018.
- The FCA's approach to supervision and enforcement has been reiterated in two new publications and both papers are open for consultation until 21 June 2018.
- The FCA published a *Call for Input* in February 2018, on using technology to achieve smarter regulatory reporting. This publication is a discussion by the FCA about how it may be able to use technology to make regulation and regulatory reporting more streamlined. The FCA is exploring how it could use technology to make the current system of regulatory reporting more accurate, efficient, consistent and less reliant on human intervention. The FCA is asking firms for their views by 20 June 2018.

The finalised findings in relation to the Asset Management Market Study have been published as well as the 2018/19 FCA Business plan in early April. We will be covering these two publications in greater detail in our next issue.

Of course, we cannot forget the omnipresent deadline of Brexit. The FCA published two statements on the transition period and its conditions, most notably confirming that the use of cross-border passports will be sustained during the period.

Supervision Matters

FCA statement on EU withdrawal following the March European Council

28 March 2018

The FCA has welcomed the agreement between the UK Government and the EU, on the terms of a transition period that is intended to apply to the United Kingdom post-Brexit, from 29 March 2019 to the end of December 2020. In accordance with the withdrawal agreement, the following would continue to apply in the UK for the duration of the implementation period:

- All European Union law
- The utilisation of passports between the UK and EEA states by firms and funds
- Legal obligations including planning for EU law that will come into force before the end of the implementation period
- Consumer rights and protections arising from EU law

The withdrawal agreement is still under negotiation and the FCA confirmed that it would keep firms updated on its development where required.

Temporary Permissions Regime for firms and funds passporting into the UK

The FCA also referenced the government's plans to legislate for a Temporary Permissions Regime which would permit non-UK EEA firms and funds to:

- Conduct new business within the scope of their permissions
- Carry out their contractual rights and obligations
- Manage existing business
- Mitigate risks which could arise from permissions ceasing abruptly

Firms and funds solely regulated by the FCA and wishing to benefit from the temporary regime would need to notify the FCA but would not be required to apply for authorisation. The FCA confirmed that it would provide further details on this later in 2018.

The FCA is encouraging firms to complete a survey from which it is collecting information on EEA firms and funds who want to partake in the Regime.

EU (Withdrawal) Bill

The EU (Withdrawal) Bill will repeal the European Communities Act 1972 and transpose existing EU law into UK law.

The FCA is working with HM Treasury and the Bank of England/PRA to secure a smooth functioning UK regulatory framework post-Brexit, including the efficacy of the FCA Handbook. The FCA confirmed that it will provide firms with further details on this.

Firms and funds passporting into the EEA

The FCA has recommended that UK firms and funds passporting into the EEA discuss the impact of the implementation period with the applicable EU regulator in advance of the UK's withdrawal from the EU.

The FCA affirmed its readiness to cooperate with EEA regulators and the European Supervisory Authorities to manage any risks to consumer protection and financial stability.

Full article can be accessed through here.

EU withdrawal: transition and financial regulation

28 March 2018

Andrew Bailey, Chief Executive of the FCA, recently delivered a speech on the UK's withdrawal from the European Union with a focus on transition and financial regulation.

Mr Bailey began his speech by recognising that although "Brexit could disrupt the financial system directly", the UK banking system could support the economy even if a "disorderly" Brexit were to occur. To mitigate the risks associated with withdrawal, Mr Bailey re-emphasised the importance of legal frameworks, continuing to support existing cross-border contracts and avoiding disruption to the availability of new financial services.

Focus was given to the fact that risks, such as firms not being able to perform their contractual obligations by losing their passporting permissions, would impact not just the United Kingdom, but also the EU. Mr Bailey made the point that because the UK and the EU "share a common concern to preserve financial stability", making the best use of the implementation period through cooperation and the engineering of solutions is of paramount importance. The best mitigation of risks would be an agreement between the UK and the EU27 on how to treat existing contracts. This would enable firms to conduct regulated activity within a supportive regulatory framework.

Mr Bailey also cast light on the role of regulators; emphasising the importance of "engagement and goodwill" between regulators to ensure a smooth transition. Firms were reminded of the government's "fall-back plan" to grant non-UK EEA firms temporary permissions to allow them to run their business as usual and perform contractual obligations.

In his concluding statements, Mr Bailey stressed the "importance of and benefits from" free trade and open financial markets, in particular to wholesale markets. He advocated his support for negotiating a free trade agreement that includes financial services, to "uphold the public interest" of financial stability and consumer protection.

Full speech can be accessed here.

FCA publishes new proposed guidance on financial crime systems and controls

27 March 2018

The guidance introduces a new insider dealing and market manipulation chapter that will be relevant to firms subject to SYSC 6.1.1R. It's important to note that whilst there is significant overlap between Market Abuse Regulation ("MAR") and SYSC 16.1.1R, the key distinction is that firms subject to the latter are required to counter the risk of financial crime as well as detect and report it. The new chapter provides examples of good and poor practice and provides "self-assessment" questions with respect to governance, risk assessments, policies, procedures and ongoing monitoring when it comes to actively preventing insider dealing and market manipulation.

Full article can be found here.

Outlining the FCA's approach to authorisation

15 March 2018

Sarah Rapson, Director of the Authorisations Division within the FCA, delivered a speech at the Association of Professional Compliance Consultants (APCC) Annual Conference which outlined the FCA's approach to authorisation, focusing on three key areas:

- How authorisations will be used to deliver the FCA Mission
- How the FCA will help firms to meet their minimum standards
- How the FCA is improving its overall approach, whilst being more transparent about its own performance

Ms. Rapson explained that within the FCA's Mission Framework, authorisation is used as a remedial tool for the prevention of harm, by ensuring that firms and individuals meet the minimum standards and requirements set upon them. She underlined that the FCA aims to be proportionate in the information it requires from firms, as well as the scrutiny it places upon the applications themselves. There is no "one-size fits all" and the FCA is guided by the principles of good regulation and recognises the differences in business models of the firms seeking authorisation. Ultimately, the FCA's approach is determined by the risk of harm a firm can cause to the UK financial markets and consumers.

Ms Rapson also discussed the initiatives the FCA has in place to help firms who are new to the market, or have innovative business models, with meeting their regulatory requirements and understanding an ever-changing regulatory landscape. A major part of this is with the provision of pre-application support and allowing innovative firms to test new products or services within a safe environment. The FCA also recognises that firms in the initial phase of their lifecycle may find it difficult to meet their authorisation standards in full. In these cases, the FCA will carefully consider the firm's situation with the possibility of granting authorisation subject to certain restrictions, limitations or requirements that it will need to meet following authorisation. This support can range from a simple phone call to clarify certain aspects of regulation, to full on-going support to help with the preparations for an authorisation application and shaping of the firm's business model.

Finally, the FCA's ambition was outlined as the continuation of improvement to its overall approach to authorisation, to ensure that maximum public value is delivered. Ms. Rapson also highlighted how authorisation will continue to be used to help with the improvement of conduct and culture within firms, and it will continue to be imaginative in its ability to allow for growing innovation and competition.

Overall, the FCA's aim is to allow for ease of engagement with firms during the authorisation process. By being clear about the expectations they set upon them, the FCA will hopefully allow firms to be able to navigate their own on-going regulatory requirements with greater proficiency and gain further comfort with the FCA as a regulatory body.

Full speech can be found here.

Transforming culture in financial services

12 March 2018

The FCA has published a discussion paper on transforming financial services culture. The paper presents views on what a good culture might look like, how to change culture through the role of regulation as well as the role of incentives to change the culture in firms for the better.

The report highlights that the regulator's attention is firmly on culture and governance through assessing the behaviour of individuals as well as the firms. The FCA has considered the roles of management, rewards and decision making by the introduction of the Senior Managers and Certification Regime (SM&CR) which creates a formal link between the behaviour of individuals and the conduct of the firm. The SM&CR also targets the minimum acceptable standards for the behaviours of the individual and the firm and aims to encourage a culture where senior managers take responsibility for identifying where harm might occur, and take preventative action.

In a speech on 19 March 2018, the Chief Executive of the FCA said "...The role of regulation in culture is not to attempt sweeping rules, but rather to use rules and supervision to create the right incentives and to provide tools to diagnose the key characteristics. And we can prompt and persuade. On the role of reward, as I have discussed it is another influence to create the right incentives for good culture. And, finally on leadership, there is no question in my mind that it plays a crucial role in shaping culture. I can safely predict that the issue of culture and its role in the conduct of firms will run and run, as it should, because it should not stand still".

The discussion paper is available here as well as the speech given by Andrew Bailey on the same topic.

Recent developments in financial markets

Recent financial developments

On 1 March 2018 Andrew Bailey, Chief Executive of the FCA gave a speech at the Association for Financial Markets in Europe ("AFME"), International Capital Market Association (ICMA) and International Swaps and Derivatives Association (ISDA) breakfast briefing. He covered developments in the markets, the introduction of MiFID II and the FCA's work on LIBOR.

Market developments

Mr Bailey stated that over the past year the financial markets had been relatively insulated to news that would otherwise have been expected to increase risk or the general level of uncertainty. Mr Bailey talked about the "progression and increasing resilience of the core banking system" as a result of 10 years of policy reforms. However, recently he said that we have seen sharp falls in the prices of risky assets and a corresponding rise in volatility. He also discussed the largest ever one-day movement of the Chicago Board Options Exchange's Volatility Index, noting that the movement in volatility was potentially amplified by investors closing out leveraged volatility based strategies, and that falling equity prices were not accompanied by such significant increases in the spread of high-yield corporate bonds.

Mr Bailey also argued that in reaction to the financial crisis there has been a general shift in financial intermediation away from bank balance sheets to market based activity by investors, usually through investment management vehicles. He noted that this shift raises the following questions:

1. Does the decline in bank intermediation mean that their role as shock absorbers (by expanding dealer inventories in times of market correction) are now at risk in a way that threatens stability?
2. Is the system exposed to pro cyclical behaviour by investors as they seek to exit en masse?
3. Are there features of the system today, such as the larger number of open ended investment funds, which mean that there are risks to stability that need to be tackled?

In this context, Mr Bailey explained that the FCA has been examining the risks from open-ended fund structures following the experience with property funds after the European Union referendum. Another key area of concern is algorithmic trading, an area with some notable cases where algorithms are used poorly, leading to wider consequences.

MiFID II

Mr Bailey noted that the FCA's highest priority was ensuring that MiFID II did not lead to market disruption. The fact that post-implementation systems could accommodate the heavy trading levels experienced in February bodes well for the FCA's objective of market continuity.

MiFID II seeks to enhance investor protection and improve market transparency, efficiency and oversight, notably by migrating significant trading volumes from OTC markets to more transparent trading venues. As expected there was a notable decrease in OTC equity trading in January and February 2018. Mr Bailey stressed that it was too soon to draw strong conclusions relating to the effect MiFID II will have on the financial system. However, he thanked wholesale firms for their efforts in preparing for the Directive and stated that despite some inevitable "roughness around the ages", it appeared that preparations had paid off. He noted that there have not yet been any major operational disruptions to trading and this is evidence that the liquidity of financial products in scope of MiFID II have not been adversely affected. Mr Bailey also stated that the FCA expected all firms to comply with the new regulations although it does not intend to use its enforcement powers in a disproportionate manner.

LIBOR

Finally, Mr Bailey discussed LIBOR and reiterated his previously stated position that LIBOR reference rates are no longer supported by significant volumes on transaction, and advising that work on the transition to alternative reference rates is underway around the world. The prevailing consensus is that in future interest rate markets will be centered on Risk Free Rates chosen by industry groups, such as the Sterling Over Night Average ("SONIA") in the UK and Secured Overnight Financing Rate (SOFR) in the U.S. However, there are instances where it is not practical or economic to change reference rates and the Intercontinental Exchange Benchmark Administration is considering a voluntary agreement to sustain LIBOR past the end of 2021. It is also possible that a "LIBOR Proxy" could be produced to serve as a legacy benchmark.

Full speech can be accessed here.

Revised European Venture Capital Fund (EuVECA) regulation comes into force

1 March 2018

The original EuVECA regulation was adopted in 2013 to support the venture capital market considering the newly stringent and burdensome AIFMD rules. Following on from this, 1 March 2018 saw the introduction of revisions to the regulation with the aim of providing greater flexibility to VC funds.

The amendments are designed to encourage wider use of this regime and ultimately drive an increase in investments made in the SME market. The key changes are as follows:

1. Authorised (full scope) AIFMs will be able to be able to become registered under the EuVECA regulation
2. The scope of eligible investments is expanded
3. "Own funds requirement" has been clarified
4. With respect to cross-border marketing an EuVECA fund, host Member States can no longer impose any fees or administrative requirements

The full legislation can be found here.

Proposed changes to the AIFMD and UCITS Directives

On 12 March 2018, the European Commission (EC) published a proposal for amendments to the UCITS and AIFMD directives with respect to cross-border distribution of investment funds in the EU.

The proposals are part of the EU's Capital Markets Union (CMU) objective, which is the creation of a true single market for capital in the EU by 2019. Another EU objective is to have a common rulebook across the EEA to ensure a level playing field, so that business across the EEA would not be restricted or hampered by domestic interests and variations in requirements.

The proposals aim to harmonise the existing fragmentation across the EU Member States, which has come about due to regulatory barriers, regulatory fees and burdensome administrative and notification requirements. The EC has seen that these factors have resulted in few collective investment schemes being marketed and thus has presented damage to the competitive nature of the EU financial market.

The fact that the proposed AIFMD Third Country Management and Marketing Passport has not been implemented has hindered marketing by managers that are based in countries outside the EEA. The majority of capital raising for Alternative Investment Funds (AIFs) is currently undertaken under National Private Placements Regimes, either because the manager is based outside the EEA, or non-EEA AIFs are being marketed.

There are some interesting statistics presented in the paper:

1. 70% of all assets under management are held by investment funds registered for sale only in their domestic market
2. Only 37% of UCITS and about 3% of AIFs are registered for sale in more than three Member States

With respect to AIFMD, it is proposed that the below changes will be amended within the directive:

1. The definition of "pre-marketing" and the conditions which must be met to enable the EU AIFM to do so
    a. This new definition appears restrictive and prohibits any pre-marketing taking place after a fund has been formed. This is the case even if it is made clear that any documents are in draft and there is no opportunity to invest in the AIF until marketing approval is obtained, which is currently permitted.
2. New notification process for AIFMs wishing to cease marketing activities for an EU AIF
    a. This proposal sets certain conditions that must be met and makes it much more difficult for firms to put a formal end to marketing in a Member State
3. Greater consistency in the treatment of retail investors across different types of funds.
    a. There is a proposal to set minimum standards for any Member State that permits marketing to retail investors.

With respect to UCITS, the below changes are proposed within the directive:

1. Regulators cannot require a physical local presence in the Member State where UCITS are marketed and grants permission to use electronic/digital communication with investors
2. Alignment of national procedures for notification processes

Certain articles will also be deleted from the UCITS directive and implemented with further enhancements to the new Regulation on the facilitation of cross-border distribution of funds. This includes amendments to marketing communications guidelines and the overall alignment of standards designed to suit and protect retail investors. Additionally, further changes will mean that information on the specific rules will be more transparent and published by ESMA.

The new Regulation, together with amendments made to the UCITS and AIFMD directives, will focus on:

1. Transparency on the marketing requirements specific to each Member State
2. A time limit given to competent authorities to verify notifications submitted by AIFMs
3. Transparency and proportionality of fees and charges compared to supervisory tasks carried out
4. Centralised database of all AIFMs, UCITS Management Companies, AIFs and UCITS
5. Introduction of strict pre-marketing definitions (aligned with proposed changes in the AIFM directive)

Most UCITS funds and UCITS ManCos tend be already established within the EEA, and the barriers faced by UCITS funds are currently less of a problem than those faced by managers of AIFs. It is feared that the new proposals will not necessarily aid the wider distribution of AIFs, and the proposed requirements may cause more problems.

For further information on the amendments and the new Regulation, please refer to the Regulation Paper and Directive.

Enforcement Matters

FCA bans former Bank Chair from the financial services industry

6 March 2018

The FCA issued a press release stating that it had banned the former Chair of a well-known UK bank from the financial services industry due to a lack of fitness and propriety.

The FCA found that the individual demonstrated an unwillingness to comply not only with the FCA's standards and rules, but also with the internal procedures of the Firm for which he held a fundamental role to lead by example. This showed a clear lack of integrity and risked undermining the FCA's objectives of consumer and market confidence.

The individual was found to have breached the bank's owns policies and procedures by using work equipment to make inappropriate telephone calls to premium rate chat lines, sending and receiving sexually explicit email messages, and other messages discussing illegal drugs, despite having been previously warned about his misconduct. The individual has also since been convicted for the possession of illegal drugs.

Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA commented that the individual "failed in his duty to lead by example and to meet the high standards of integrity and probity demanded by the role. These high standards are what the financial services industry and the wider community rightly expect of its senior individuals".

Click here to read the press release in full.

FCA fines and bans former investment bank trader

5 March 2018

The FCA has fined a short-term interest rate derivates trader £180,000 and has banned him from ever conducting any regulated function in the financial services industry.

The individual traded products referenced to CHF (Swiss Franc) and JPY (Japanese Yen) LIBOR and acted as the primary JPY LIBOR submitter for the bank for a duration of time.

Mark Steward, Director of Enforcement and Market Oversight at the FCA, said that the trader's actions in discounting the standards governing LIBOR submissions "threatened the integrity of important benchmarks" and that he had no place in the financial services industry.

The FCA found that between July 2008 and March 2010, the trader had:

1. Requested the bank's CHF LIBOR submitters to alter their submissions so that he could benefit from the trading positions he was responsible for
2. Took his own trading positions into account when acting as the bank's primary JPY LIBOR submitter
3. Improperly agreed with a trader at another bank to make JPY LIBOR submissions to suit that trader's requests

The FCA concluded that the trader was knowingly involved in the bank's failure to comply with proper standards of market conduct and considered that, by ignoring the risk of his actions being improper, he was not fit and proper to perform any regulated financial activity.

The full article can be found here.

Restrictions imposed on two Financial Services Firms and both Firms are placed into insolvency

2 March 2018

The Financial Conduct Authority ("FCA has placed restrictions on two Financial Services Firms following an investigation by both the FCA and the United States Department of Justice (DOJ). Using its powers under the Financial Services and Markets Act 2000, the FCA has imposed requirements on the entities to refrain from carrying on any regulated activity and not to dispose of any firm or client assets without the FCA's consent. With regards to the client assets held, the entities must refrain from doing anything with the money or assets other than to settle unclosed trades.

The DOJ with assistance from the FCA, has conducted a separate investigation into one of the entities involvement in securities fraud relating to stock of various US publicly-traded companies and international money laundering associated with that conduct. The entity, amongst other companies and individuals, has been charged with securities fraud and money laundering violations.

Following an assessment by the FCA with regards to the financial position of the two entities, both were placed into insolvency. The FCA considered it to be necessary for insolvency practitioners to take over the management of both entities and, following an urgent application to the High Court, administrators were appointed.

If you would like to read the full article, please click here.

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For more information about our global locations and expertise, visit www.duffandphelps.com

About Duff & Phelps

Duff & Phelps is the premier global valuation and corporate finance advisor with expertise in complex valuation, disputes and investigations, M&A, real estate, restructuring, and compliance and regulatory consulting. The firm's more than 2,000 employees serve a diverse range of clients from offices around the world. For more information, visit www.duffandphelps.com.

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