REGULATORY FOCUS

A synopsis of the Financial Conduct Authority's (FCA) latest news and publications issued in May 2017.

ISSUE 107

MiFID II topics and challenges

We would like to remind firms of two of the most pressing and challenging issues under MiFID II, which relevant firms need to be addressing with some urgency if they are not already doing so. These are:

Transaction reporting

The obligation to make transaction reports widens under MiFID II. It applies to firms undertaking relevant transactions; including those that conduct discretionary management, and Exempt CAD firms undertaking reception and transmission of orders. Firms that already undertake transaction reporting under the current regime will also need to make systems changes, as the number of data fields will increase from 23 to 65.

Receipt of research

MiFID II places more restrictive provisions on investment management firms that receive investment research. Currently, firms can pay for relevant research using dealing commission. However under MiFID II, firms will be subject to new requirements, such as the introduction of Research Payment Accounts and the need to set a research budget where the client is charged for it. Alternatively, firms will be able to pay for research themselves.

We recommend that, if you have not already done so, you should review how the above rules affect your business, assess any systems changes required and talk to vendors and service providers. There is likely to be a long implementation timeframe for the above two topics.

ESMA MiFID II Investor Protection Q&As

Q&As were issued by ESMA on 6 June covering various topics of investor protections, such as best execution, suitability, recording of telephone conversations and electronic communications, inducements (research), post-sale reporting and information on costs and charges. The document can be found here.

ESMA Final Report - Guidelines on MiFID II product governance requirements

MiFID II has introduced product governance requirements to ensure that firms that manufacture and distribute financial instruments act in clients' best interests during the life cycle of products or services. These guidelines were issued on 2nd June. These specifically address the "target market assessment" as this is perceived to be the most important issue for ensuring the common, uniform and consistent application of the product governance requirements. The Guidelines can be found here.

Fourth Money Laundering Directive (4MLD)

The 4MLD takes effect on 24 June 2017 and therefore firms should be reviewing the requirements and assessing where their policies and procedures need to be updated.

The aim of the 4MLD is to harmonise and bring a more risk based approach to the prevention of money laundering and terrorist financing across the EU.

It addresses several key areas, such as:

Simplified and enhanced due diligence - Firms need to start their Know Your Customer (KYC) process with a risk assessment to determine the level of risk posed by each customer. The 4MLD itself provides some guidance on what factors and types of evidence should be considered for low or high risk clients. It also categorises these risks into:

- Customer risk
- Product risk
- Service risk
- Transaction or delivery channel risk
- Geographical risk

Firms should not apply simplified due diligence without such a written risk assessment

EU AML and CTF risk assessment - To assist firms, the EC will publish an EU level risk assessment report and each member will produce a national report. The UK published its assessment in October 2015 and a second National Risk Assessment is expected in October 2017, ahead of the Financial Action Task Force Mutual Evaluation in February 2018

Third Country Equivalence Regime - The list of 'equivalent jurisdictions' will be scrapped and instead, the European Commission will identify high risk non-EU countries with strategic deficiencies in AML/CTF standards, requiring firms to apply Enhanced Due Diligence (EDD) when dealing with persons or entities established in these countries

Politically Exposed Persons (PEPs) - The definition of PEP has been changed to formally encompass persons entrusted with a prominent public position domestically. The Wolfsberg Group recently published updated guidance as to how financial institutions should handle the money laundering risks posed by PEPs. Of interest is their view that the industry practice of "once a PEP, always a PEP" runs counter to an appropriate risk based approach and should be considered very carefully before being applied. The 4MLD corroborates this approach and requires firms to apply EDD on PEPS for only 12 months after the individual ceases to be a PEP

Tax crimes - Tax crimes are already covered under UK law but will also apply to other EU jurisdictions under 4MLD. Firms will face an increased burden to ensure that their systems and controls are sufficient to identify tax crimes. Policies and procedures will need to be amended to include those tax crimes that fall under the definition of "serious crimes".

If you would like to read the 4MLD please click here.

FCA asks some of UK's largest asset managers for their Brexit contingency plans

We understand that the FCA has written to several of the UK'S largest asset managers asking about their plans for Brexit. The Regulator wants to find out how firms are planning for Brexit, so that it can formulate its own response and deepen its understanding of the challenges posed to the industry. The Regulator made it clear that this was not a formal data request and it was not asking firms to undertake additional work.

Supervision Matters

FCA's disclosure rules following application of PRIIPs Regulation

2 May 2017

The FCA has published a Policy Statement (PS) responding to feedback received on its Consultation Paper (CP) published in July 2016, CP 16/18: *Changes to disclosure rules in the FCA Handbook to reflect the direct application of the PRIIPs Regulation*. The CP sets out the FCA's proposals for reflecting the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation in its Handbook.

The PS will be relevant to most firms that provide, advise on, or sell investments or investment services to the UK retail market.

When the Regulation comes into force on 1 January 2018, it will require persons to prepare, publish or provide a Key Information Document (KID) for each PRIIP manufactured.

The Regulation states that a PRIIP is an investment (regardless of its legal form) where the amount repayable to the retail investor is subject to fluctuations because of the exposure to reference values or the performance of one or more assets which are not directly purchased by the retail investor. It also relates to an insurance product that offers a maturity or surrender value that is wholly or partially exposed, directly or indirectly, to market fluctuations.

The PS will be relevant to:

- Firms that manufacture, advise on or sell retail investment products that fall within the scope of the PRIIPs Regulation. It will be necessary to produce, publish or provide KIDs for packaged retail products such as funds
- UCITS Management Companies which will need to replace UCITS Key Investor Information (KII) documents with the PRIIPs KID after a transitional period
- Firms that are authorised fund managers of non-UCITS retail schemes (NURS) or an investment company with variable capital (ICVC) that is a NURS. These firms will be able to produce a NURS key investor information (NURS-KII) document instead of a KID during a transitional period
- Firms that currently provide investors in NURS or Qualified Investor Schemes (QISs) with a Key Features Document (KFD) or a simplified prospectus

During 2017, the FCA will consult separately on changes to the Enforcement Guide (EG) and Decision Procedure and Penalties manual (DEPP). The consultations will set out FCA's enforcement approach for investigations as well as decision making procedures under the PRIIPs Regulation.

Please see here for the Policy Statement.

Remuneration in CRD IV Firms, Policy Statement PS17/10

3 May 2017

The FCA has published its final Handbook text and guidance on the remuneration requirements in CRD IV. Firms must ensure that they comply with the guidelines for the 2017 performance year onwards, together with the amended FCA Handbook rules and guidance.

The Capital Requirements Directive IV (CRD IV) itself came into effect in January 2014, with one of its aims being to ensure that remuneration policies and practices were consistent with and promoted sound and effective management without encouraging excessive risk taking. In December 2015, the European Banking Authority (EBA) published guidelines which detailed how it considered the CRD IV requirements should be applied. The Guidelines came into effect on 1 January 2017, and as a result the FCA has made changes to its Handbook within SYSC 19A and SYSC 19D to bring these into alignment.

The FCA previously consulted on the proposed rules and guidance in Consultation Paper CP16/28.

The Policy Statement contains guidance covering:

- The application of proportionality (IFPRU remuneration code (SYSC 19A))
- BIPRU remuneration code (SYSC 19C) and Pillar 3 disclosures on remuneration (BIPRU 11)
- Dual regulated firms (SYSC)

In addition to providing guidance with regards to individuals that have been defined Remuneration Code Staff for only part of the financial year, the Regulator also highlights those firms which it considers ought to have a Remuneration Committee in place. Currently under SYSC 19C.3.12R (1) a BIPRU firm that is 'significant in terms of its size, internal organisation and the nature, scope and complexity of its activities must establish a remuneration committee'. However, the guidance makes it clear that firms may in certain instances justify not establishing a separate Remuneration Committee on the basis of proportionality. In such cases, firms would be required to demonstrate that the functions which would have otherwise been conducted by the Remuneration Committee can be conducted with sufficient authority and independence from those performing executive functions within the firm.

The FCA also provides further clarity with regards to BIPRU 11.5.20R, advising that a firm will be considered 'significant' if on the appropriate date the firm has 'relevant total assets exceeding £50 billion'.

If you would like to read the full policy statement and review the revised Handbook text, please click here.

Cyber Resilience

18 May 2017

In our last edition of Regulatory Focus, we highlighted that the FCA is becoming increasingly focused on the threat posed by cyber risks and is aiming to help firms to build their resilience against them. To assist firms, the FCA has now published a cyber resilience page on its website, which collates key documents that firms may find useful as well as underlining the actions it expects a firm to undertake should a cyber incident take place.

The FCA believes that a 'security culture' must be fostered within firms from the top down. Towards this goal, information assets (hardware, software and people) should be protected, breaches detected and incidents responded to and recovered from promptly. Constant evolution is required to meet new threats. Cyber security is viewed by the FCA as a shared responsibility between governments and other regulators internationally and nationally.

In accordance with Principle 11, firms are required to report any material cyber incidents, defined as an event which:

- Results in a significant loss of data, or the availability or control of the firm's IT systems
- Impacts a large number of victims
- Results in unauthorised access to, or malicious software present on, the firm's information and communication systems

As well as containing reference material, the webpage provides information about who to contact in the event of a material cyber incident.

If you would like to view the webpage, please click here.

Suitability thematic review

18 May 2017

The FCA has issued a report which highlights the main findings from its review into the market for pensions and investment advice.

Suitability of advice was one of the seven priorities highlighted by the FCA in its 2016/17 Business Plan and the review which commenced in April 2016 sought to assess the suitability of advice and quality of disclosure in the financial advisory sector.

The review consisted of an assessment of a sample of advice files (1,142 files from 656 firms) and the findings were as follows:

- In 93.1% of cases, the sector provides suitable sales
- In 4.3% of cases, the sector provides unsuitable advice
- In 2.5% of cases, the sector provides unclear advice

As such, the Regulator has concluded that the results are indicative of a successful adoption of the Retail Distribution Review.

The FCA will issue further detail about its findings in publications throughout 2017 and 2018. These will include examples of good and poor practice which Firms will be mindful to consider.

Whilst there will be further changes to the advice and disclosure requirements through MiFID II, PRIPPs and IDD; the FCA has highlighted that it is committed to repeat this review in 2019. This review will encompass advice given since 2018, assess firms' implementation of the new requirements and enable it to assess the results against thought gained in this exercise.

If you would like to view the report, please click here.

Other publications

Criminal Finances Act 2017 - new corporate offences of failure to prevent the facilitation of tax evasion

The Criminal Finances Bill 2016, which received Royal Assent in 2017, introduces a new strict liability criminal offence for a corporate entity that fails to prevent the criminal facilitation of tax evasion. The guidance suggests that the corporate offence will apply from September 2017.

The offences are wide ranging, applying typically to companies and partnerships not only in the UK but also to those based or operating overseas. It is very similar to the Bribery Act 2010 and holds the relevant body (company or partnership) responsible for preventing those who act for or on its behalf (associated persons) from facilitating tax evasion. Firms will need to have reasonable procedures for the prevention of tax evasion. The associated person will be regarded as carrying out the conduct that amounts to a UK facilitation offence if this person was aware of, or took steps with a view to, the fraudulent evasion of tax by another person.

Final guidance has not yet been issued but the draft Government Guidance (the "Draft Guidance") sets out six "guiding principles" for firms designing prevention procedures, which are again similar to those issued by the Ministry of Justice in relation to the Bribery Act:

1. Risk assessment
2. Proportionality of risk-based prevention procedures
3. Top-level commitment
4. Due diligence
5. Communication (including training)
6. Monitoring and review

The UK offence will be investigated by HMRC and the non-UK offence will be investigated by the Serious Fraud Office or National Crime Agency. Penalties include unlimited financial penalties and other orders such as confiscation orders or serious crime prevention orders. For a regulated entity that is criminally liable, this could affect its regulatory status.

We recommend that firms should carry out a risk assessment to determine the impact on its business. The Draft Guidance can be used to plan communications, train staff and brief Senior Management on their responsibilities and potential liabilities under the Act.

The Guidance can be found here.

JMLSG Publishes revisions on Parts II and III of its AML and CTF Guidance

9 May 2017

The Joint Money Laundering Steering Group (JMLSG) has published its proposed revisions to Part II (sectoral guidance) and Part III (specialist guidance) of its anti-money laundering (AML) and counter terrorist financing (CTF) guidance for the financial services industry in the UK.

The purpose of these revisions is to align JMLSG guidance with the proposed new Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017. These Regulations contain provisions relating to the 4MLD and will replace the Money Laundering Regulations 2007 and the Transfer of Funds (Information on the Payer) Regulations 2007.

The proposed revisions to the JMLSG Guidance are also believed to be consistent with the, as yet unpublished, European Supervisory Authorities Risk Factor Guidelines.

For the consultation version of Part II click here.

For the consultation version of Part III click here.

ESMA

ESMA updates its MAR Q&A's

ESMA has updated its Q&A on practical questions regarding the implementation of the Market Abuse Regulation.

They include new answers regarding:

- Disclosure of inside information relating to Pillar 2 requirements
- Blanket cancellation of orders policy

ESMA will periodically review these Q&As and update them when required.

To access the Q&As please click here.

ESMA publishes updated AIFMD and UCITS Q&As

The AIFMD Q&A's include three new questions and answers on:

- Reporting to National Competent Authorities (NCAs) on the breakdown between retail and professional investors
- Notification of AIFMs on the AIFs to be managed, if domiciled in another Member State
- Use by an AIF of the exemption for intra group transactions under EMIR

The UCITS Q&A's include one new question and answer on:

- Application to UCITS of the exemption for intragroup transactions under EMIR

The purpose of these Q&A documents is to promote common supervisory approaches. If you would like to review the Q&A please click here.

EU Agrees New Rules to Increase Access to Venture Capital Funding

30 May 2017

The EU has agreed on reforms to the European Venture Capital Funds ("EuVECA") and European Social Entrepreneurship Funds ("EuSEF") regulations which are intended to increase access to venture capital funding for small and growing companies. Larger managers with more than € 500 million of assets under management will be permitted to manage and market funds which can still fall under EuVECA and EuSEF regulations. Additionally, EuVECA funds will now be allowed to invest in small mid-cap companies and small and medium-sized enterprises (SMEs) listed on growth markets in addition to unlisted SMEs. These rule changes aim to broaden the range of businesses venture capital funds can invest in and deliver economies of scale to investors by allowing larger managers to market EUVECA funds.

To view the press release please click here.

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.

M&A advisory, capital raising and secondary market advisory services in the United States are provided by Duff & Phelps Securities, LLC. Member FINRA/SIPC. Pagemill Partners is a Division of Duff & Phelps Securities, LLC. M&A advisory and capital raising services in the United Kingdom and across Europe are provided by Duff & Phelps Securities Ltd. (DPSL), which is authorized and regulated by the Financial Conduct Authority. In Germany M&A advisory and capital raising services are also provided by Duff & Phelps GmbH, which is a Tied Agent of DPSL. Valuation Advisory Services in India are provided by Duff & Phelps India Private Limited under a category 1 merchant banker license issued by the Securities and Exchange Board of India.

Compliance Consulting

Ian Manson
Managing Director, Compliance Consulting
ian.manson@duffandphelps.com

Jane Stoakes
Director, Compliance Consulting
jane.stoakes@duffandphelps.com