DUFF & PHELPS
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Regulatory Focus

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In this edition of Regulatory Focus, the experts in Duff & Phelps' UK Compliance and Regulatory Consulting team, provide a detailed synopsis of the latest news and publications issued by the Financial Conduct Authority during December 2018.

Happy New Year to all our readers!

Temporary Permissions Regime for EEA Passporting Firms and Funds.
This year promises to be an interesting one with Brexit looming and the terms still to be clarified. We have written in previous reports, issues about the temporary permission regime ("TPR") for EEA passporting firms and funds into the UK. If there is no implementation period and the passporting regime falls away when the UK leaves the EU, the TPR will enable EEA firms and funds to continue to operate their business within the UK for a limited period after exit day. **Firms wishing to use the TPR need to notify the FCA via the Connect system between 7 January 2019 and 28th March 2019.** As we have previously explained, once firms have notified the FCA that they wish to use this regime, they will be allocated a landing slot, which is a time period within which they will have to submit their FCA authorisation application.

The window for notification is now open. Please note that once the notification window has closed firms will not be able to use the TPR, so we strongly advise firms that need to use this regime to notify the FCA as soon as possible. This is a straight forward process and an FCA guide to the TPR notification on Connect can be found here.

Upcoming events
We continue to work towards the implementation of the Senior Managers and Certification Regime (SM&CR) which comes in on 9th December 2019, so less than 11 months' time. We will be holding a breakfast briefing on 26th February, where we will be talking about implementing SM&CR as an LLP. We encourage any firms that are LLPs to attend this event to hear Peter Ewing from the FCA speak about the FCA's expectations on LLP's, Nick Colston from Simmons and Simmons talk about the legal challenges facing LLPs and their members, Mark Turner from Duff & Phelps talk about the practical implementation of SM&CR and Marie Barber discuss how SM&CR impacts the tax status of LLPs' members.

On 20th February we will be holding a breakfast seminar, where Chris Lombardy and Jane Stoakes from Duff & Phelps will discuss the SEC's priorities for 2019 and key topics for SEC regulatory examinations. They will be joined by Karen Anderberg, a partner from law firm Dechert, who will talk about the legal implications for SEC registered UK firms who experience poor examinations by the SEC. We encourage any UK SEC registered investment advisers to attend this session.

The Financial Services Contracts Regime

17 December 2018

The Government published a draft legislation for the Financial Services Contracts Regime (FSCR), enabling firms who do not enter the TPR to wind down their UK business in an orderly fashion if the UK ends up leaving the European Union without a withdrawal agreement. The draft legislation can be found here.

This will ensure current contractual obligations not covered by the TPR can continue to be met. The draft legislation published by the Government for the FSCR will provide a limited period during which EEA passporting firms can continue to service UK contracts entered into before the UK leaves the EU. This will allow their UK business to wind down in an orderly manner.

The legislation will be relevant where EEA firms passporting into the UK in order to carry on a regulated activity here either:

- fail to notify the FCA that they wish to enter the TPR or;
- are unsuccessful in securing authorisation at the end of it, but still have regulated business in the UK.

The FSCR will allow EEA firms to run off existing UK contracts before conducting an orderly exit from the UK market.

The FSCR will automatically apply to notify the FCA that they wish to enter the TPR "but have pre-existing contracts in the UK which would need a permission to service". The FSCR will apply for a maximum of 15 years for insurance contracts and 5 years for all other contracts, although the Treasury has the option to extend these periods if a joint assessment by the FCA and the PRA deems it to be necessary. FSCR firms must keep authorisation in their home state and inform the FCA if their authorisation is cancelled or altered.

The FSCR will provide two discrete mechanisms:

- Supervised run-off ("SRO") – this mechanism is for both EEA firms with UK branches or top-up permissions in the UK, as well as firms who entered the TPR but did not secure a UK authorisation at the end.
- Contractual run-off ("CRO")– this mechanism is for remaining incoming services firms.

SRO will work much in the same way as the TPR. Firms will be within the UK regulatory perimeter and will be 'deemed' Part 4A authorised for the purposes of winding down their UK regulated activities in an orderly manner. They will be regulated and supervised by the UK regulators like other Part 4A authorised firms but will not be able to enter into new contracts with UK customers. They will only be allowed to carry out the regulated activities which are required to service their pre-existing contracts and wind down relevant contracts.

CRO firms may not have an existing relationship with UK regulators and under the CRO they will remain supervised by their home state regulators. The CRO will work on the basis of a limited exemption from the general prohibition of carrying on a regulated activity in the UK, unless that person is authorised or exempt, for the purposes of winding down UK regulated activities in an orderly manner. As with the SRO, providers will not be able to enter into new contracts with UK customers. They will only be allowed to carry out the regulated activities which are required to service their pre-existing contracts and wind down relevant contracts.

The FCA will publish a consultation paper on both mechanisms in early 2019.

To read the full press release click here

Statement on treatment of Gibraltar in FCA's handbook after Brexit

20 December 2018

The FCA released a statement confirming its intention to retain its present regulatory stance on Gibraltar within the FCA Handbook, post Brexit. The regulator also published draft amendments to the FCA Handbook, scheduled to be implemented on 29 March 2019 and proposing the same rights and obligations on Gibraltar-based firms that are currently in place.

The FCA's statement is consistent with the Government's commitment that Gibraltar-based financial services firms should be able to exercise passporting rights in the UK until December 2020. This means that they would not need to enter into the TPR or the FSCR, mentioned above.

The FCA also confirmed in the statement that the Financial Services Compensation Scheme will also continue to apply to Gibraltar-based firms exercising passporting rights in the UK until the end of 2020.

For more information, click here

FCA proposes permanent measures for retail CFDs and binary options

7 December 2018

The FCA is proposing to ban the sale, marketing and distribution of binary options and restrict the sale, marketing and distribution of contracts for difference ("CFDs") and similar products to retail customers. The regulator has issued two Consultation Papers addressing the respective issues, with the catalyst for action being perceived investor protection risks.

The FCA's proposals echo the measures introduced by the European Securities and Markets Authority ("ESMA") in June of this year.

However, the FCA is also proposing to apply its rules to "closely substitutable products", including so-called turbo certificates, knock outs, deltas and 'securitised' binary options, none of which were included in ESMA's temporary measures. These measures are being proposed to "stop firms getting around these measures by offering retail consumers CFDs in slightly different legal forms".

If confirmed, the measures would be permanent.

For CFDs sold to retail clients, the FCA is proposing to require firms to:

- limit leverage to between 30:1 and 2:1 by collecting minimum margin as a percentage of the overall exposure that the CFD provides;
- close out a customer's position when their funds fall to 50% of the margin needed to maintain their open positions on their CFD account;
- provide protections that guarantee a client cannot lose more than the total funds in their CFD account;
- stop offering monetary and non-monetary inducements to encourage trading; and
- provide a standardised risk warning, which requires firms to tell potential customers the percentage of their retail client accounts that make losses.

The binary options Consultation Paper is open until 7 February 2019, with the CFD Consultation Paper also open until 7 February for feedback on the proposed measures and 7 March for feedback on the discussion of other complex derivative products.

The FCA will consult separately in early 2019 on a potential ban on the sale of derivative products referencing cryptocurrencies to retail consumers, following on from the commitment made in the UK Cryptoasset Taskforce Final Report published in October 2018.

For more information, click here.

FCA publishes Decision Notice against former bank CEO for AML failings

4 December 2018

The FCA imposed a financial penalty of £76,400 on a former bank CEO for failure to maintain effective anti-money laundering (AML) systems. The FCA said it believes that the individual acted without due skill, care and diligence and was knowingly concerned in a breach by the bank of its obligations to maintain effective AML systems.

The FCA said that in its view the individual failed to:

- assess and mitigate AML risks in a culture of non-compliance;
- ensure AML systems and controls were given sufficient attention;
- appropriately oversee, manage and adequately resource the Firm's Money Laundering Reporting Officer (MRLO) function.

The FCA explained that because of the above failings, employees at the Firm didn't appreciate the need to comply with AML requirements and the MLRO function was ineffective. This led to systemic failures throughout the Firm in relation to its AML requirements and controls.

The individual has appealed the Decision and referred the case to the Upper Tribunal.

In October 2016 the FCA took action against the Firm and its former MLRO where both agreed to a fine at an early stage.

For more information, click here

Director pleads guilty to illegally operating an investment scheme and fraud

7 December 2018

In a case brought by the FCA, a company director has pleaded guilty in relation to four charges including the illegal operation of an unauthorized investment scheme, misleading consumers and two related counts of fraud.

The FCA alleged that between October 2015 and November 2017, the Director promoted a deposit taking scheme, marketed as an investment package without authorisation from the FCA. The FCA put forward the case that, by misleading investors, he received approximately £600,000 in investment funds via this scheme.

For more information, click here

FCA bans an individual from acting as a non- executive director and fines them for failure to declare conflicts of interest

14 December 2018

The FCA has published a Final Notice in relation to an individual who has failed to act with integrity in her role at two mutual societies.

Between January 2009 and May 2011, the individual, described as an experienced UK investment professional who was the chief executive of their own investment consultancy, was a NED and chair of the investment committees at two mutual societies.

During this period, both mutual societies sought guidance from the individual during a process to seek investment management services.

The individual was involved in discussions with both mutual societies about a well-known US investment firm whilst at the same time seeking consultancy work from this same firm.

In the FCA's press release on the matter, Mark Steward, Executive Director of Enforcement and Market Oversight of the FCA said:

'Directors have a duty to disclose or avoid conflicts of interest, so they can be addressed by the board.'

He explained that the individual placed herself in a position where her NED duties may have been in conflict with potential opportunities that she was pursuing.

The FCA explained that the actions of the individual breached its Statement of Principle 1 which states that *an approved person must act with integrity in carrying out her accountable actions.*

Prior to the publication of its Final Notice, the FCA's initial Decision Notice had been referred to the Upper Tribunal on 21 December 2012 and subsequently the Court of Appeal. The Supreme Court denied the individual's application for permission to appeal.

For more information click here

FCA ban an individual from working in the financial services sector

20 December 2018

An individual became the sole director of a debt management firm between October 2013 and May 2014, which he had acquired from its previous owners using his own debt management company. The FCA has said that the individual directed or allowed the money of customers of the acquired Firm to be used in its purchase.

The purchased Firm, which went into administration around seven months after its purchase, offered debt reduction services to its customers. This involved collecting and handling the money of its clients before making full and final settlement offers to their customer's creditors.

The FCA explained that the Firm's office account contained *commingled funds*, consisting of the Firm's own monies and those of its clients. Payments were made from the purchased Firm's office account to the previous owners, including money the Firm held in trust for its clients. As a result, there was a significant shortfall of over £7 million from over 4,000 of its customers when the Firm went into administration.

The FCA explained that the terms of the Sale and Purchase Agreement mandated the previous owners being paid seven monthly payments of £20,000 between November 2013 and May 2014. However, the purchased Firm transferred funds from its office account totalling £322,500; considerably more than the terms of the sale and purchase agreement, to the previous owners during these seven months. The previous owners have also been banned by the FCA for dishonestly misappropriating money.

In its Final Notice, the FCA has made an order prohibiting the individual from *performing any function in relation to any regulated activity carried on by an authorised person, exempt person or exempt professional Firm as his conduct demonstrated a serious lack of honesty and integrity*.

Mark Steward, Executive Director of Enforcement at the FCA has explained that the individual was *dishonest and showed a complete lack of integrity* and that the FCA had taken the strongest action it could take.

For more information click here

Bank fined £32.8 million for serious failings in its probate and bereavement process

19 December 2018

The FCA has fined a Bank £32.8m for its failure to effectively process the accounts and investments of deceased customers. This case is of interest generally as it relates to a failure to comply with the FCA principles on management and control, treating customers fairly and being open and cooperative with the regulator.

Total funds of over £183m were not transferred to the rightful beneficiaries, resulting in 40,428 customers being directly affected. There was also a failure by the Bank in not divulging information relating to the issues with the probate and bereavement process to the FCA once it became aware of them.

Between 1 January 2013 and 11 July 2016, the Bank breached Principle 3 and Principle 6 by failing to:

- take reasonable care to organise and control its probate and bereavement process responsibly and effectively, with adequate risk management systems;
- treat its customers, and those who represented them on their death, fairly.

Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA, stated that:

'These failings took too long to be identified and then far too long to be fixed. Firms must be able to identify and respond to problems more quickly especially when they are causing harm to customers. The FCA will continue to be on the lookout for firms with poor systems and controls and will take action to deter such failings to ensure customers are properly protected.'

Between 26 November 2013 and 1 May 2015, the Bank also breached Principle 11, by failing to disclose information relating to the issues with the probate and bereavement process to the FCA. Not only did the Bank fail to notify the FCA of the nature or extent of the issues it faced, but it was also selective in the information it provided. In line with Principle 11, the FCA expects authorised firms to be open and cooperative and to disclose to them anything which they might reasonably expect notice of.

The Bank did not contest the FCA's findings, however, they did rectify the issues promptly and correctly once the board and senior management had been notified. In view of this, the Bank qualified for a 30% (Stage 1) discount. Without this discount, the FCA would have imposed a financial penalty of £46.9m.

To read the press release, please click here.

FCA response to the Competition and Markets Authority's final report

12 December 2018

The Competition and Markets Authority (CMA) published their final report and remedies for its market investigation of investment consultancy and fiduciary management services. This report will be relevant to any firm involved in managing assets for pension schemes, either now or in the future, as well as individuals who are saving for retirement.

The CMA undertook this investigation due to a reference made by the FCA as part of their September 2017 asset management market study, which identified serious competition issues in the investment consultancy and fiduciary management service markets. The CMA's final report confirms that it has found competition issues in each market.

The findings in the fiduciary management market included:

- A large proportion of pension schemes choosing the same provider that they use for investment consultancy when choosing a fiduciary management provider, giving these firms an "incumbency advantage".
- Prospective customers not having clear information about providers' fees and historic performance, exacerbated by a high cost of switching providers once pension schemes have engaged a fiduciary manager.

With respect to investment consultancy services, the key issues found in the report were the low levels of engagement by some pension schemes in selecting and monitoring their provider, in conjunction with difficulties faced by pension schemes in accessing information about the quality of their provider. As a result, pension scheme trustees are less able to drive competition between providers and so providers' incentives to compete are reduced. If competition was to be improved, this would improve the value for money received by pension schemes and could have a significant positive impact on the pension pots of millions of individuals in the UK.

In terms of remedies to address the competition issues identified, the CMA has proposed a package which aims to promote increased trustee engagement. The CMA aims to provide trustees with more comprehensive information on the fees and corresponding performance of fiduciary managers and investment consultants. The CMA has also made several recommendations to support its remedy package, including a recommendation to HM Treasury to broaden the FCA's regulatory scope to include the activities of investment consultants, ensuring greater future oversight of this sector.

For more information, click here

Securitisation Regulation: PRA and FCA joint statement reporting private securitisations.

20 December 2018

Both PRA and FCA have released a statement which sets out the way in which firms must make information regarding private securitisations available to their UK competent authorities. This statement is issued to ensure application by all UK established originators, sponsors and securitisation special purpose entities (SSPE) from 15 January 2019.

1. The Securitisation Regulation requires the originator, sponsor and SSPE of a securitisation to make certain documentation available to:
   - Holders of a securitisation position
   - Competent authorities who are responsible for the supervision of the securities
   - Potential investors.

2. Where a prospectus has been drawn up in compliance with the Prospectus Directive, information on the securitisation will be made available by means of a securitisation repository. However, the Securitisation Regulation is yet to state how information has to be made available on securitisation where no prospectus has been drawn up in compliance with the Prospectus Directive.

3. The PRA and FCA have the power to enforce the rule in which the originator, sponsor or SSPE of a private securitisation established in the UK must make information readily available.

4. The PRA and FCA will implement their right to ensure that information is readily available from 15 January 2019. However, they will only require a summary of the relevant information, but the full set of information should still be available if required at any point by the competent authority.

5. The PRA and FCA expect notifications to be provided for the below securitisations with the following frequency:
   - For non-Asset Backed Commercial Paper (non-ABCP) securitisation, upon each issuance of securities from 1 January 2019, or for non-ABCP securitisations which do not involve the issuance of securities, upon the creation of each new securitisation position from 1 January 2019.
   - For ABCP securitisation, upon the first issuance of securities at the programme level from 1 January 2019, and subsequently upon the first issuance of securities at the programme level following the inclusion of a new seller within the programme.
   - For both non-ABCP and ABCP securitisations, upon any information being made available to holders of a securitisation position under article 7(1)(f) or (g) of the Securitisation Regulation.

6. Where at least one of either the originator, sponsor or SSPE of a securitisation is established in the UK, that entity should send a completed notification form to:
   I. The PRA at securitisation.information@bankofengland.co.uk where at least one of the originator, sponsor or SSSPE is a PRA-authorised firm.
   II. The FCA at private.securitisation@fca.org.uk where at least one of the originator, sponsor or SSPE is established in the UK but is neither a PRA-Authorised firm nor an occupational pension scheme.
   III. The PRA at securitisation.information@bankofengland.co.uk and the FCA at private.securitisation@fca.org.uk where a securitisation involves at least one entity (I) and at least one entity referenced in (II).

For more information click here.

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CTA intelligence Awards 2018

ADVISORY AND CONSULTANCY: TAX
Drawdown Private Equity Services Awards 2018

BEST ADVISORY FIRM – REGULATON AND COMPLIANCE
HFM Week 2018

BEST GLOBAL CYBERSECURITY SERVICES PROVIDER
Hedgeweek Global Awards 2018

BEST COMPLIANCE CONSULTING TEAM
Women in Compliance Awards 2017

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Hedgeweek Global Awards 2017

EUROPEAN SERVICES - BEST CONSULTANCY FIRM
CTA Intelligence 2016

BEST EUROPEAN OVERALL ADVISORY FIRM
HFM Week 2016

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