DUFF & PHELPS

REGULATORY FOCUS

A synopsis of the Financial Conduct Authority's (FCA) latest news and publications issued in November 2016.

ISSUE 101

As 2016 draws to a close we can reflect on what a year it has been, with the EU Referendum and the resultant uncertainty ahead. Despite the vote for the United Kingdom to leave the EU, we will still be part of it for some years to come, and therefore firms still need to work towards compliance with EU Directives that will be implemented in the next year or two. The market abuse regulation came into force on 3 July and there is additional regulatory change ahead.

On that front, next year is an important year for firms to progress further with their preparations for MiFID II so that they are ready and compliant when it is implemented in January 2018.

There have been a number of publications from the European Securities and Markets Authority (ESMA) during November, which may be interesting for some firms.

For instance on 18 November, ESMA published Questions and Answers in relation to MiFID II. One is an updated Questions and Answers on Transparency and the other is on Market Structures.

On another note, on 16 November ESMA issued an updated Questions and Answers paper on the application of AIFMD. This document is aimed at competent authorities to ensure that supervisory practices are consistent in the application of AIFMD and to clarify the rules for managers subject to AIFMD. The latest document covers various subjects such as remuneration, notifications and reporting.

Another regulatory change that will affect all firms is Accountability II, or the roll out of the senior managers and certification regime to the non-banking financial services industry. We expect to gain more clarity on how this will work in 2017 ready for implementation in 2018.

There is therefore much to be done on the regulatory front and we look forward to working with firms in what promises to be a busy and interesting year in 2017.

OUR RECENT AWARDS*

BEST EUROPEAN OVERALL ADVISORY FIRM 2016
HFMWeek

BEST OVERALL ADVISORY FIRM IN THE U.S. 2014
HFMWeek

BEST ASIAN ADVISORY FIRM FOR REGULATION AND COMPLIANCE 2014
HFMWeek

BEST EUROPEAN ADVISORY FIRM FOR REGULATION AND COMPLIANCE 2014
HFMWeek

BEST ADVISORY FIRM REGULATION AND COMPLIANCE 2014
HFMWeek

BEST SEC REGISTRATION TEAM – HONG KONG 2014
Acquisition International

UCITS FUND ADVISOR OF THE YEAR – IRELAND 2014
Acquisition International

*Awarded to Kinetic Partners, which was acquired by Duff & Phelps in January 2015

Enforcement Actions

FCA prohibits six individuals for their part in an unauthorised collective investment scheme

11 November 2016

The FCA has brought a case against six individuals who, across a three-year period running from July 2008 to November 2011, were involved in the operation of an unauthorised collective investment scheme through three separate companies. It was concluded by the Regulator that all six individuals were not fit and proper to perform any function in relation to any regulated activity, and therefore will no longer be permitted to be approved persons.

The unauthorised scheme resulted in over 100 investors losing approximately £4.3million. Over the last two years the FCA has brought cases against the individuals operating the scheme and they have received various sentences which accumulate to over 30 years of imprisonment. Convictions were also given for the offences of carrying on a regulated activity without being authorised or exempt, conspiracy to defraud and possessing criminal property.

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

Statement on the FCA's review of a well-known bank's treatment of customers

8 November 2016

In January 2014, the FCA appointed a skilled person to review a major UK bank's treatment of small and medium enterprise (SME) customers which were transferred to its Global Restructuring Group (GRG) during the period between 2008 and 2013. The skilled person undertook a review which covered 207 cases over a six-year period.

The report identified areas of inappropriate treatment with regards to its SME customers, some of which were considered to be systematic. The bank failed to put in place suitable governance and oversight procedures to ensure that an appropriate balance was reached between the interests of the bank and its SME customers. The report also found that the bank failed to recognise and manage the conflicts of interest with regards to GRG's commercial and turnaround objectives.

On 8 November 2016, the bank responded to the report and announced that it has put in place a new complaints review process and an automatic refund system for complex fees charged to its SME customers. The FCA considered this an important step but advised that it will further review the report and assess whether any further work needs to be conducted.

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

Supervision Matters

The Regulatory sandbox

7 November 2016

The regulatory sandbox is one of the three projects which form part of the FCA's Project Innovate, an initiative started in 2014. The sandbox aims to provide a 'safe place' where new business models, financial products, method of delivery and services can be tested in a live environment with consumers remaining appropriately protected.

The first sandbox closed on 8 July 2016 and the FCA has now published a list of 24 successful applicants who met the criteria and were selected out of 69 applicants to form the first regulatory sandbox cohort. They will begin testing shortly.

The regulatory sandbox is the first to be seen from regulators worldwide and highlights the FCA's commitment to innovation and its willingness to think outside of its regulatory parameters. The FCA anticipates it to be an intense process for both itself and the selected firms but maintains a positive outlook for the prospect that new financial products will be brought into the financial market as a result of this experiment.

Those firms who would like to partake in this initiative can apply to be part of the second cohort. The application period is now open and will close on 19 January 2017. Firms will need to be ready to test in May 2017.

For more information on the initiative and how you can apply, please see here.

Effectiveness and proportionality: FCA's financial crime priorities

10 November 2016

Rob Gruppetta, Head of the Financial Crime Department at the FCA, gave a speech on 10 November 2016 at the FCA's Financial Crime Conference. The speech summarised the FCA's views on the effectiveness of the current regulatory regime in relation to financial crime, particularly with respect to proportionality and value for money, as well as giving some insight into its future direction and the FCA's supervisory priorities.

The FCA recognises that anti-money laundering regulations are onerous and acknowledges that some are questioning whether the regulations deliver value for money. The BBA estimated that its members collectively spend £5 billion each year on compliance activities to combat financial crime, which means that the cost of each suspicious activity report (SAR) submitted to the FCA potentially runs to thousands of pounds. Although the FCA highlighted that it cannot change the law, it would like to know where the FCA's guidance is considered to be a hindrance or unrealistic and seeks feedback from the industry. The FCA is also open to the idea of firms using new technology or methods which they consider may be helpful in complying with the regulations. Equally, the FCA noted that if firms are using expensive systems which are not effective in preventing money laundering, they should reconsider their approach.

Mr Gruppetta made reference to the new Joint Money Laundering Intelligence Taskforce (JMLIT) which has made good progress in supporting information sharing between the industry and the authorities. The FCA believes that sharing information about launderers benefits the industry in many ways, can help firms to understand whether a transaction is suspicious and can enable suspicious patterns to be detected that may have otherwise been missed. Mr Gruppetta additionally touched upon the new Financial Crime Return, REP-CRIM, which will be introduced from 31 December 2016. The purpose of the return is to assist the FCA with identifying those firms that are exposed to a high risk of financial crime and to allow the FCA to focus its supervisory activities accordingly. He highlighted that for the first reporting period this data should be submitted on a best endeavors basis.

With regards to the results of the FCA's 'Systematic Anti-Money Laundering Programme', the FCA found that firms are tackling financial crime and the processes in place within many firms are working reasonably well. However, the FCA stated that there were some serious deficiencies in some firms that required significant changes to be made. It found that generally firms intended to comply but often did not execute the process effectively. The causes were often weaknesses in governance, serious under-investment in staffing and under-developed controls. These often led to firms taking an ineffective risk based approach, with poor standards of due diligence and monitoring, particularly for higher risk businesses.

The Regulator has advised that it will soon begin inspecting a random sample of smaller firms that it supervises under the Money Laundering Regulations such as stockbrokers, safe deposit box providers, financial advisors and life insurers. The FCA aims to review about 100 firms per year under this programme. Mr Gruppetta explained that this exercise is not intended to 'catch smaller firms out'. It should provide a better picture of the risk posed by different sectors and provide the FCA with comfort that its risk assessment is appropriate. It should also improve standards across the industry by making it clear that no firm is too small to receive a visit from the FCA.

In conclusion Mr Gruppetta made reference to the forthcoming changes that will be required to HMT's Money Laundering Regulations and the FCA's Financial Crime Guide as a result of the Fourth Money Laundering Directive. The FCA advised that although there will inevitably be new guidance issued, it will take into account the feedback to the 'Better Regulation Executives' review when drafting new guidance to ensure that there is not an excessive amount of material produced. All guidance will be subject to public consultation and the FCA welcomes feedback from the industry.

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

FCA Fees and Levies

17 November 2016

In CP16/33 the FCA outlined its proposals for Regulatory fees and levies for 2017/18. This is part of the annual fees consultation cycle which concludes in June or July the following year when feedback is published together with final fees and levy rates.

Each chapter of the consultation paper covers a self-contained area of the policy. Firms may be particularly interested in Chapter 3 where the Regulator seeks comments on the fee blocks through which it proposes to recover its costs in implementing MiFID II.

The Regulator seeks comments by 16 January 2017 and if you would like to read the CP in full, please click here.

FCA highlights weak price competition in some areas of asset management industry

18 November 2016

The FCA has released the interim findings of its study into competition within the asset management sector, which indicates that there is weak price competition in various areas of the industry. The study, which began in November 2015, looked at whether retail and institutional investors receive value for money in the context of asset management services.

Chief Executive of the FCA, Andrew Bailey, highlighted the importance of the study, stating that "it is vital that we do everything possible to enable people to accumulate and earn a return on their savings which can meet their lifetime needs" and that in order to achieve this "we need to ensure that competition in asset management works effectively to minimise the cost of investment". Mr Bailey emphasised the need for effective competition within the sector, especially at a time when interest rates continue to remain low.

The Regulator found that:

- Customers frequently pay high charges on actively managed funds, with limited competition between these types of funds; these costs do not tend to be justified by the funds' returns
- Competition is generally stronger amongst passively managed funds
- Firms within the industry have, on average, enjoyed high profits over a prolonged period with significant price clustering, despite there being a large number of firms in the sector
- Fund objectives are not always fully clarified and specified benchmarks are not always appropriate

The FCA has responded to these findings by proposing various new measures aimed at enhancing competition in the industry, which include:

- An enhanced duty on asset managers to act in the best interests of their investors
- An all-in fee which makes it easier for investors to identify costs and charges
- Measures to help retail investors to identify which funds are appropriate for their circumstances, for example requiring asset managers to fully clarify the objectives of the fund and making it easier for investors to recognise consistent underperformance
- Clearer disclosure of fund charges, including in ongoing communications to retail investors
- Measures aimed at increasing the clarity of costs and charges information for institutional investors

Mr Bailey surmised that "we want to see greater transparency so that investors can be clear about what they are paying and the impact charges have on their returns. We want asset managers to ensure investors receive value for money through pursuing energetically their duty to act in their customers' best interests".

The regulator is currently seeking feedback on its findings including whether it should make market investigation references to the Competition and Markets Authority (CMA). Furthermore, the FCA has recommended that HM Treasury considers bringing the provision of institutional investment advice within the FCA's regulatory perimeter.

The FCA plans to carry out additional competition work by looking further into the retail distribution of funds, especially with regards to the role played by financial advisers and platforms in terms of providing value for money.

Please click here for more information.

EU Benchmarks Regulation

The EU Benchmarks Regulation will apply in the UK from 1 January 2016 and introduces requirements for EU-based index providers who provide benchmarks. The regulation aims to prevent conflicts of interest and consistently ensure benchmarks are robust and reliable.

It defines an index as a figure that is publicly available and regularly determined, either by applying a formula to or making an assessment of a representative set of underlying data.

Once their benchmarks are used, index providers will become benchmark administrators expected to apply to their competent authority (FCA) for authorisation or registration. Benchmark contributors do not require authorisation or registration, but firms ('supervised entities') that are already authorised under other EU rules may be subject to additional requirements.

Supervised entities are not permitted to use benchmarks provided by administrators that are not authorised or registered, or subject to the third country regime if the benchmark is provided outside of the EU. Written contingency plans must be maintained by supervised entities that use benchmarks.

This regulation may affect firms if they fall into one of the following categories:

- **Benchmark administrators**: those who provide indices used in financial instruments traded on trading venues or via systematic internalisers in the EU, mortgage or consumer credit contracts or investment funds
- **Supervised contributors**: those who are authorised persons and contribute input data that is not readily available to the administrator and provide the input data for the purpose of a benchmark determination
- **Benchmark user**: an authorised person who issues a financial instrument that references an index, for instance to measure the performance of an investment fund through an index either to track the return of the fund or to define its asset allocation. It could also be where it is used to determine the amount payable under a financial instrument or a mortgage or consumer credit contract by referencing an index

For the full article, visit:
www.fca.org.uk/markets/benchmarks/eu-regulation

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