



# regulatory focus

Issue 89

A synopsis of the Financial Conduct Authority's (FCA) latest news and publications issued in October 2015.

Welcome to Duff & Phelps' Kinetic Partners division's latest issue of *regulatory focus*, our regulatory newsletter for the financial services community.

## Statement from the FCA following the announcement by HM Treasury of changes to the Senior Managers Regime

On 15 October 2015, HM Treasury announced that it intends to extend the Senior Managers' and Certification Regime ("SM&CR") to include all regulated financial services firms. This marks a departure from the original position that implementation should be for the banking sector only.

The SM&CR will replace the Approved Persons Regime ("APR"). The Parliamentary Commission on Banking Standards ("PCBS"), which has been highly critical of the APR, identified deficiencies in the regime, the effect of which it believes has extended beyond the banking sector. Therefore, an overhaul of the existing regime was recommended. This has been effected through the introduction of the SM&CR, the implementation of which is intended to ensure that senior managers will be subject to the same industry wide 'duty of responsibility'.

Tracey McDermott, Acting CEO of the FCA, stated that the extension is "an important step in embedding a culture of personal responsibility throughout the financial services industry".

There will also be a requirement on firms to certify as fit and proper any individual who performs a function that could cause significant harm to the firm or its customers, both on recruitment and annually thereafter.

Banks, building societies, credit unions and PRA-regulated investment firms will be subject to the SM&CR from 7 March 2016. The intention is for firms such as financial advisers, asset managers, stock brokers and consumer credit firms to become subject to the regime in 2018.

A detailed summary of the individual components of the SM&CR can be found [here](#).

## Regulatory highlights this month include:

- MiFID II - the road ahead
- Investor Protection under MiFID II
- FCA introduces new rules on whistleblowing
- FCA bans Magnus Michael Peterson (sentenced to 13 years imprisonment for fraud) from the financial services industry

### Regulatory Update

We also provide regulatory updates on key developments as and when these arise. For further information, including recent updates, please visit [here](#).

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### OUR RECENT AWARDS

ONE STAR 'VERY GOOD'  
ACCREDITATION  
2015  
Best Companies UK

BEST OVERALL  
ADVISORY FIRM IN THE US  
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

Mr Peterson “purposely used investors’ money to prop up his business, and then lied in order to cover up his deception”.

His conviction and resulting sentencing were deemed to demonstrate a “serious lack of honesty and integrity” by the FCA.

These new rules should be considered as non-binding guidance for all other FCA regulated firms.

## Enforcement Matters

### FCA bans Magnus Michael Peterson (sentenced to 13 years imprisonment for fraud) from the financial services industry 26 October 2015

The former head of the hedge fund Weaving Macro Fixed Income Fund Limited, Magnus Michael Peterson, has been banned from performing any function related to a regulated activity. Mr Peterson was sentenced in January 2015 to 13 years’ imprisonment in relation to a range of fraud offences resulting in losses to clients totalling approximately \$536m.

On 19 January 2015 Mr Peterson was convicted of the following fraud related offences: furnishing false information relating to accounts; trading with intent to defraud a creditor; obtaining a money transfer by deception; two counts of making a false instrument; fraud by abuse of position; dishonestly making a false representation to make a gain for self/another or cause loss to other/expose other to risk; and carrying on the business of a company with intent to defraud creditors or for other fraudulent purpose.

Mark Steward, Director of Enforcement and Market Oversight at the FCA, said Mr Peterson “purposely used investors’ money to prop up his business, and then lied in order to cover up his deception”. The crimes were committed between 31 July 2003 and 31 March 2009 when Mr Peterson was approved by the FCA to carry out various controlled functions.

The Final Notice can be found [here](#).

### FCA bans Kweku Mawuli Adoboli from the financial services industry 16 October 2015

The FCA has banned Kweku Mawuli Adoboli from performing any function in relation to a regulated financial activity, following his conviction on 20 November 2012 of two counts of fraud by abuse of his position as a senior trader at UBS AG (“UBS”). Mr Adoboli made unauthorised trades on the ETF Desk (the “Desk”) at UBS between 1 June 2011 and 14 September 2011 that caused it to incur losses amounting to \$2.25 billion.

UBS was fined £29.7 million in 2012 for systems and controls failings that allowed the unauthorised trading to take place. These included inadequate risk management, a lack of integration between systems and inadequate front office supervision. In addition, John Christopher Hughes, the most senior trader on the Desk, was banned in May 2014 for allowing the Desk’s profit and loss to be misstated over an extended period, which contributed to Mr Adoboli’s unauthorised trading continuing unchecked.

On the same day, Mr Adoboli was sentenced to seven years’ imprisonment following an investigation by the City of London Police and prosecution by the Crown Prosecution Service. His conviction and resulting sentencing were deemed to demonstrate a “serious lack of honesty and integrity” by the FCA and, in reaching its decision, the FCA considered the level of risk posed by Mr Adoboli to consumers, financial institutions and market confidence generally, in addition to all the relevant circumstances of the case.

The press release can be found [here](#).

The Final Notice can be found [here](#).

## Supervision Matters

### FCA introduces new rules on whistleblowing 6 October 2015

The FCA has published new rules on whistleblowing that will take effect in September 2016. The rules apply to deposit-takers (banks, building societies and credit unions) which have over £250 million in assets, PRA-designated investment firms and insurers subject to Solvency II. The FCA states that these new rules should be considered as non-binding guidance for all other FCA regulated firms and, once the rules have been in place long enough for the FCA to consider their effectiveness, the FCA will assess whether to make the rules binding on other regulated firms, such as investment firms, stockbrokers and consumer credit firms. The rules are intended to complement the FCA’s recent initiatives to reform senior management arrangements and remuneration in the financial services industry.

Under the new rules firms must ensure that they have appropriate internal whistleblowing arrangements in place. These include the appointment of a whistleblowers’ champion, who should be a non-executive director subject to the Senior Managers Regime or the Senior Insurance Managers Regime, and the preparation of a whistleblowing report to the Board annually.

Relevant firms will have until 7 September 2016 to comply, although the appointment of the whistleblowers’ champion will need to take place by 7 March 2016 to take effect with the rest of the Senior Managers Regime. From this date, the whistleblowers’ champion will be responsible for oversight of the firm’s implementation of the new regime.

The following will also be required of relevant firms under the new rules: procedures in place should cover all types of whistleblowing disclosure, i.e. not just those made by employees or those protected under the Public Interest Disclosure Act; all UK-based employees of the firm must be informed about the FCA and PRA whistleblowing services; appointed representatives and tied agents of the firm will be required to tell their UK-based employees about the FCA whistleblowing service; and the firm will need to inform the FCA if it loses an employment tribunal case with a whistleblower. It should be noted that no regulatory duty will be placed on a firm’s staff to blow the whistle.

The press release can be found [here](#).

## MiFID II - the road ahead

20 October 2015

David Lawton, Director of Markets Policy and International at the FCA, delivered a speech at the FCA MiFID II conference in London. It focused on how the final technical rules and implementation of MiFID II will affect the wholesale sector:

He set out that timeframes are a "moving target" because the Commission, Parliament and Council have not yet given full approval to the technical standards and delegated acts.

The key date for the obligations of MiFID II to take effect is 3 January 2017. Six months prior to implementation (3 July 2016) the UK and other member states must have transposed the directive into national law or rules. Mr Lawton noted that this timeframe is "challenging" for both the industry and regulators. He also gave assurances that the FCA is "treading the line between getting things right and moving quickly, carefully". However, he did highlight that firms should already be in the early stages of planning, considering how the new rules, as far as they are known, will affect them.

### Regulatory Technical Standards ("RTS") /Implementing Technical Standards ("ITS") timetable

On 28 September 2015 ESMA published the draft technical standards which were sent to the Commission for endorsement. The standards will be subject to scrutiny by the European Parliament and Council which is a process that can take several months. However, if no changes are made the technical standards could theoretically be finalised during the first quarter of 2016.

### Delegated Act timetable

The Commission has been considering the advice provided by ESMA in December 2014, however the delegated acts have not yet been finalised and published. It is predicted that this will happen in November or December 2015.

Once finalised and published the Council and Parliament have the standard period of three months in which to put forward any objections (with an option to extend for a further three months). They also have the option to provide early confirmation that they do not wish to raise any objections.

### Domestic rules

The elements of MiFID II which were not contained in directly applicable regulations are required to be transposed into national law via legislation passed by UK Parliament or FCA Handbook rules.

However, the FCA is unable to consult on "real options" until they have reviewed the near final EU rules. The FCA's expectation is to be in a position to publish a consultation paper in December 2015, followed by at least one more consultation in early 2016.

Some firms such as: Organised Trading Facilities; firms undertaking speculative trading in commodity derivatives and firms using high frequency trading methods will be required to apply for new permissions or to apply for authorisation as a result of the introduction of MiFID II. The FCA intends to make new application forms available in early 2016 and it will start accepting draft applications from April 2016.

### Engagement strategy

Mr Lawton set out the various ways in which the regulator is engaging with the industry, including: the FCA website; signposting in Regulation Round Up and Market Watch newsletters; speaking at conferences and discussions with trade association representatives. He cited the cost benefit questionnaire which was sent out to approximately 5,000 firms as being a useful tool. Responses will be used to ensure that decisions on areas in which the regulator has discretion are proportionate and sensible.

### Significant changes since Consultation Papers

- 1. Bond market liquidity:** this has been an area of heavy debate due to the need to balance assisting price discovery and ensuring that the market is not harmed by too much transparency. ESMA's revised position is to use an Instrument-by-Instrument approach ("IBIA") with an element of a Class of Financial Instrument approach ("COFIA") for bonds new to trading. This has allowed ESMA to ensure that bonds marked as 'liquid' are indeed liquid and avoid unintended consequences.
- 2. Commodity firms:** the limits which could be set by competent authorities in relation to the size of positions in commodity derivative contracts has been a matter on which there has been heavy petitioning. After receiving feedback, ESMA has decided that the cap for holding a position will now fall between 5% and 35% of deliverable supply or open interest, depending on the time to maturity of the contract (as opposed to the original proposal of between 10% and 40%). For non-financial entities there are hedge exemptions to allow them to offset the risks for their commercial activities.

Energy companies, agricultural businesses and food manufacturers who use commodity derivatives are currently exempt from financial regulation. However, ESMA has been asked to design rules for when commodity speculation in this context requires oversight from regulators. Once a certain percentage of trading is reached in the relevant asset class in EU markets, these firms will become subject to MiFID rules along with capital and liquidity requirements.

### Conclusion

- MiFID II "is important legislation with the potential to change markets significantly, for the better". Therefore, when considering the ways in which to implement the changes at firm level an appreciation of the spirit and intent of the legislation is required;
- The scale of this legislative change is "huge" and Mr Lawton emphasises the need for firms and their senior managers to be preparing for the changes based on the information available at present; and
- The FCA is preparing its Contact Centre staff to be ready to answer MiFID II questions once the legislation is finalised. Firms are encouraged to use this resource to assist them with their implementation plans.

The speech can be found [here](#).

Mr Lawton gave assurances that the FCA is "treading the line between getting things right and moving quickly".

## Disruptive innovation in financial markets

26 October 2015

In a speech at the OECD (Organisation for Economic Cooperation and Development), Mary Starks, Director of Competition at the FCA, discussed the rise of technical innovation in the financial services industry, otherwise known as Fintech, and the ability of the financial services to keep up with developing technological solutions. As Director of Competition Ms Starks stressed the uniqueness of the UK regulator's competition mandate and highlighted the FCA's continued dedication to assisting innovation and entry into the market as well as providing support for consumers to ensure they are able to make good choices.

Ms Starks acknowledged that in terms of innovation, the FCA has previously been more involved with larger firms as they pose a greater risk of detriment. However the regulator is looking to ensure that it also works with new innovative businesses and has established for that purpose the Innovation Hub, introduced as part of 2014's Project Innovate. The Innovation Hub aims to allow new Fintech firms to contact the FCA to gain a greater understanding of the regulatory framework, be provided with informal steers, provide feedback about elements of the rules which may put up barriers to innovation as well as providing the regulator with information about the industry. To date, the Innovation Hub has provided support to 144 firms and has developed themed events that will aim to bring the regulator together with a range of firms that are in the Fintech business stream.

Ms Starks also spoke about the FCA's subsidiary, the Payment Systems Regulator ("PSR"). She commented that just under half of the Fintech population is involved with payments innovation. It was reiterated that the aim of PSR is to remove barriers to competitive innovation and ensure that through collaborative measures between users and PSR innovators, users of the payment system are provided with good results.

In relation to disruption, Ms Starks spoke about other innovations including the rise of crowdfunding and peer to peer lending. Ms Starks highlighted the rapid growth of this sector following the tightening of borrowing and lending from banks. Other disruptive models include the emergence of entirely online banks that no longer require physical branches, blockchain (a public ledger for virtual currency transactions and share trading) technology which includes Bitcoins, as well as the use of a digital wallet, e.g. contactless payments and Apple Pay.

Ms Starks summarised that disruptive innovation does not yet threaten to force out larger players in the Fintech sector or financial services industry and there are some clear benefits to consumers emerging. However, this is an area of progress and therefore concepts like the operation of cheaper business models, the speed at which technology develops, as well as the ease of technological advances for consumers, the formation of new markets to reach new categories of consumers, off the shelf technology and big data are areas to be kept under review.

The speech can be found [here](#).

## Investor protection under MiFID II

20 October 2015

In a speech delivered at the FCA MiFID II conference, London, David Geale, Director of Policy at the FCA, spoke about the impact of MiFID II on the retail sector:

Mr Geale highlighted that although the regulator and industry awaits publication of the final implementing measures of the directive by the European Commission (anticipated for the end of 2015), firms can be confident about some of the key changes and can start to prepare for MiFID II. Mr Geale discussed some of these areas and also acknowledged challenges that may arise.

MiFID II's investor protection framework aims to ensure that firms' cultures are focused on the best interests of their clients and managing any conflicts of interest. Mr Geale noted that the framework seeks to:

- Improve governance and organisational requirements for firms;
- Strengthen the conduct of business rules that apply to firms' relationships with all categories of clients; and
- Provide new powers for supervisors, at a both national and European level.

Detailed requirements for investor protection will be set out within the legislation, however it was noted that the following areas will fall under scrutiny:

### Product governance

Product governance is an area that has previously been subject to a thematic review by the FCA, however the requirements on product governance will be codified into the rules for the first time under MiFID II. MiFID II will require Executive Committees and Boards of firms to be actively engaged with policies and procedures for product governance, including product approval, deciding on target markets for particular products and ensuring that on-going monitoring is undertaken in relation to product distribution.

### Suitability of advice and due diligence

MiFID II will introduce specific requirements that firms must meet to ensure that products recommended to clients are suitable. This will include undertaking due diligence on these recommended products. Again, this is not a new area of focus as a previous review by the FCA found that inappropriate advice was being provided by firms as they were not considering costs of products sufficiently, were not undertaking appropriate risk profiling and were not performing adequate due diligence on products and services. Under MiFID II firms will need to properly understand products being recommended to clients and assess whether an alternative would better serve client's interests and objectives.

Ms Starks stressed the uniqueness of the UK regulator's competition mandate and highlighted the FCA's continued dedication to assisting innovation and entry into the market.

MiFID II's investor protection framework aims to ensure that firms' cultures are focused on the best interests of their clients and managing any conflicts of interest.

### Appropriateness, costs and adviser independence

The list of products that are currently considered complex will be expanded under MiFID II. This will include all non-UCITS collective investment schemes such as NURS and property funds. For non-advised sales of complex products, firms are expected to conduct tests to confirm whether consumers understand the nature of products in which they are buying (i.e. the "appropriateness" test). Given the increasing range of such products, it is understood that the Regulator will be looking at providing greater guidance of its expectations of what will be deemed an adequate appropriateness test between products.

In addition, there will be a focus on the transparency of costs and charges associated with investments and it is understood that the view of adviser independence across Europe will come more in line with that currently required under RDR, although the true impact will need to be confirmed by the implementation of legislation.

### Inducements and Research

A new inducements regime for firms offering independent advice or portfolio management will be introduced. Like the aims of RDR, third party payments will be banned with the exception of minor, non-monetary benefits and this ban will extend to portfolio managers for the first time.

Also, for the first time, MiFID II will provide a Europe-wide regime regarding the purchase and use of third-party research by asset managers. Although an area of significant interest within industry, this is one which will need to be kept under review until additional guidance is published.

### Remuneration

Remuneration remains a hot topic amongst many sectors, however MiFID II rules will be published that will require firms to ensure that staff are not incentivised to promote financial instruments that are inappropriate for clients. In addition, senior management will be required to be involved in approving remuneration policies and structures to ensure clients are treated fairly and to ensure that conflicts of interest are identified and appropriately managed.

It was noted that whilst some of these areas may not appear to be "new", as many have previously been subject to domestic scrutiny, the FCA urged firms to remain vigilant in relation to the proposed changes under MiFID II.

The speech can be found [here](#).

### John Griffith-Jones' speech to the Trust in Banking Conference

20 October 2015

John Griffith-Jones said that the UK financial services industry has a window of opportunity to restore public trust, partly due to the economic cycle and partly due to the political environment. In order to help industry seize this opportunity he highlighted some reforms to the financial services sector:

Too big to fail is being tackled by increased capital requirements, ring-fencing and resolution regimes. Conduct issues are being dealt with by the new Senior Management Regime, remuneration measures and the message sent out by enforcement actions, especially relating to Forex and LIBOR misconduct.

Responding to a speech made in June by the Chancellor of the Exchequer, George Osborne, Mr Griffith-Jones said that the FCA "accepts" the challenge to ensure that the UK's financial institutions are the best regulated, but "it is for the industry to deliver" on conduct.

Mr Osborne's speech marked a change in tone from the government. Mr Griffith-Jones response promised that if firms' behaviour changes for the better, that could result in lighter regulation.

The speech can be found [here](#).

### The rapidity of change

22 October 2015

Tracey McDermott, acting CEO at the FCA, delivered a speech to the City Banquet in Mansion House in which she highlighted the considerable changes that have taken place in the financial services industry since the financial crisis.

She started her speech by explaining that the conduct failures which came to light during the crisis have had far reaching effects, highlighting the fundamental errors made by both firms and regulators, identifying the deficiencies in the regulatory framework and structure and questioning some of the most fundamental aspects of fair dealing and integrity for which London's financial market is renowned. In response to this crisis, an unprecedented wave of legislative, regulatory and structural changes were implemented in order to change behaviours in both regulated entities and at the regulator. She stressed that post-crisis reforms have been, and continue to be, a challenging task and that efforts must be maintained to ensure that the reform process can be completed. She acknowledged however that the industry is "starting to see some light at the end of the tunnel" and that it is now time to concentrate efforts towards the future by finding a balance between the industry's expectations and the appropriate role played by the regulator in the reforms. In her speech, she described the three key roles that a regulator should play but also, more importantly that all industry participants must take part in changing the way financial services operate for the long term. Her address aimed to demonstrate that all market participants have a common interest in ensuring that the UK continues to have a world leading financial services industry.

Prior to describing the regulator's role she clarified the reasons why "it is imperative to have this debate now". Crises are followed by calmer periods in which regulation is less visible and less intense, leading to healthy periodic recalibrations of the regulatory approach. Ms McDermott, however, reminded her audience that a recalibration can only be completed when the lessons of the past are taken into consideration.

**Griffith-Jones said that the FCA "accepts" the challenge to ensure that the UK's financial institutions are the best regulated, but "it is for the industry to deliver" on conduct.**

“if the financial services industry is to restore the trust and confidence of those it is here to serve, firms should not just aspire to meet the rules; firms should aspire to be better than that”.

Ms McDermott stated that the two main risks faced by the industry are that 1) regulatory phases become linked to the economic ones; as the economy recovers the appetite for reforms reduces; and 2) as memories fade the lessons of the past are forgotten, leading to believe again into the “three lies” of finance: this time is different; markets are always clear; and markets are moral”. She explained that “the danger is that a sensible and intelligent desire to reduce unnecessary regulation leads the pendulum to swing too far in the other direction”. She therefore stressed that the challenge is to avoid this cycle and questioned how regulators and participants can develop a sustainable approach to regulation which help financial services live up to its aspirations and society’s expectations. She expressed “that regulators cannot deliver that outcome. Only the industry can do so. But regulators can, and should play part in helping it to happen”.

Ms McDermott then moved on to the three key roles that a regulator should play: referee, policy maker and post-match commentator.

### 1 The referee’s role

She described the regulator’s role as making sure that those it regulates play by the rules. Using a rugby analogy she set out that a good regulator needs to be like a good referee, “constantly on the pitch, keeping up with what is going on, respected, fair and consistent. Tough, where required, and at the centre of the action without being the centre of attention”. This requires rules to be set and to be enforced but also the regulator needs to use regulation to drive the right incentives and conditions for healthy, competitive and innovative markets. Despite complex retail and wholesale financial markets, Ms McDermott stressed the FCA constantly aims to ensure that its interventions reflect the reality of how people and markets actually behave.

### 2 The policy maker or groundsman

The second critical role of a regulator is to be an effective policy maker, stated Ms McDermott comparing it to the role played by a groundsman. Promoting competition plays a key part in that role, which is why the FCA aims to create the best environment to allow competition to take place by using different tools such as Project Innovate or advanced technology and data availability. However, being an effective policy maker also means that the FCA should be able to review its work and make changes to the rules when they don’t work. By way of example, Ms McDermott mentioned that the regulator has recently published proposals to remove various disclosure requirements that FCA research has shown is not used by customers. She also demonstrated that market studies and thematic review constitute a helpful tool to review the various markets and sectors the FCA regulates. She stressed though, that “effective regulation is not just about challenging the rules that are no longer needed. Effective regulation also requires that the regulator possesses the confidence and courage to recognise and address emerging risks or practices that are unsuitable”, acknowledging that the FCA has too often allowed issues to grow in size and importance before taking remedial actions. To illustrate her thoughts she quoted Winston Churchill who said that “when the situation was manageable, it was neglected, and now that it is thoroughly out of hand we apply too late the remedies which then might have effected a cure”. In order to establish a sustainable model for long-term regulation she pointed out that the FCA needs to find the right balance.

### 3 The post-match commentator

Finally, the FCA can be compared to “the post-match commentator” in its role to facilitate debate which reflects on and analyses past performance. The FCA should support and work with the industry or other interested parties to find new solutions to past and future problems but should also play a role in challenging the industry to do better; go further and faster in the quest for change. She strongly believes that “if the financial services industry is to restore the trust and confidence of those it is here to serve, firms should not just aspire to meet the rules; firms should aspire to be better than that”. She concluded her last point by setting out that both regulators and participants should constantly look for improvement and innovation and the desire to be better every year should be part of the DNA of this industry.

The speech can be found [here](#).

# regulatory focus

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