

August 2018 - Issue Highlights

- Senior Management & Certification Regime (“SM&CR”)
- Blockchain – crypto assets and Distributed Ledger Technology (“DLT”)
- Asset management from a regulatory perspective
- Competition and innovation
- Retiring guidance on inducements and conflicts of interest
- ESMA final report on suitability guidelines under MiFID II
- MLD5 published in the Official Journal of the EU
- Competition in the investment platform market
- FCA Annual Report and Accounts 2017/18
- Approach to Brexit
- Near final SM&CR rules released
- MAR Questionnaire
- MiFID II and the fight against financial crime



Important information for all firms: FCA publishes Policy Statement and Guide for Solo Regulated Firms

The FCA’s Policy Statement^[1] confirmed that the SM&CR will apply largely in line with the previous consultation papers published in July and December 2017.

The important issues to observe are as follows:

- The regime will apply from the 9th December 2019 to all FCA regulated firms.
- The second tier Senior Management conduct rules will apply to all Senior Managers and Certified Staff from that date. All the Senior Managers and Certified Staff must have been identified prior to the commencement of the regime.
- The only employees deemed exempt from the SM&CR are “ancillary staff” who, for example, may include human resource administrators, IT Support, personal assistants and receptionists.
- The fitness and proprietary checks and the certifications process must be completed by firms within 12 months from commencement of the regime.
- PR6, the Prescribed Responsibility for ensuring the governing body is informed of its legal and regulatory obligations, has been removed.
- The FCA have set out three regime tiers to outline a firm’s requirements: “limited”, “core” and “enhanced”. Firms will be able to ‘opt up’, from limited to core or core to enhanced, but if they choose to do so then they must apply all the requirements of that regime and failure to do so will be a breach of the FCA rules.
- The SM&CR applies to legal entities, rather than to groups and as such, there is no discretion to take a group-wide approach to applying the SM&CR. However, groups with multiple entities

which include an enhanced firm will be able to apply the enhanced regime to other group firms that would naturally have fallen under core.^[2]

- The SM&CR will apply where a Senior Manager performs a Certification Function, where it relates to a regulated activity, unless it is closely enough related to their Senior Management Function.
- The final rules on the status of the Head of Legal will be announced before the commencement date of the 9th December 2019.

The Consultation Paper CP18/19 introduces the Directory as ‘a new public register and user interface’ which would provide information on a wider scope of roles in a more accessible and user-friendly way in a single public location. The Paper is open for comment until 5th October 2018.

If you have any questions or would like assistance in making such assessment or project planning for SM&CR please contact us.

Newgate’s online Training Centre includes a SM&CR course.

[1] <https://www.fca.org.uk/publication/policy/ps18-14.pdf>

[2] <https://www.fca.org.uk/publication/policy/guide-for-fca-solo-regulated-firms.pdf>

Important information for all firms: FCA publishes Consultation Paper introducing the Directory

The Financial Services Register provides a public record of the firms the FCA regulate and the individuals they and the Prudential Regulation Authority (PRA) have approved. This currently includes information on a firm’s senior management, its control staff and customer facing roles.

The Financial Services Register will continue following the extension of the Senior Managers and Certification Regime (SM&CR) but will contain fewer individuals. This is because only specified Senior Manager roles at FSMA firms will then be approved and so appear on the Register

The FCA propose to introduce the Directory – a new public register and user interface that would:

- make information public on additional individuals carrying out a wider range of roles (including those who we do not approve such as financial advisers, traders, portfolio managers and additional directors)
- present information on these individuals and the Senior Managers the FCA continue to approve in a way that is more accessible and user friendly
- enable users to find information on these individuals in a single public location

The Paper is open for comment until 5th October 2018.

<https://www.fca.org.uk/publication/consultation/cp18-19.pdf>

Important information for all firms: Director of Competition's view on Blockchain and the risks it poses to consumers and competition

On 26th April, Mary Starks, the FCA's Director of Competition, gave her speech on Blockchain, assessing both its relevance to crypto assets and Distributed Ledger Technology ("DLT"), at the Authority for Consumers & Markets Conference Panel in the Netherlands.

Starks draws attention to Bitcoin's notorious reputation for dark web purchasing, but also acknowledges firms use of cryptocurrency for international money remittance. Currently the FCA remit does not include cryptocurrencies though they do regulate derivative products based on them and initial coin offerings. The UK Government recently announced the creation of a cryptocurrency taskforce part of which the FCA is involved. In a recent discussion paper, the FCA defined distributed ledger technology as 'a set of technological solutions that enables a single, sequenced, standardised and cryptographically secured record of activity to be safely distributed to and acted on by different participants – thus DLT has a huge range of applications. Starks highlights some of the competition questions DLT raises and the comparable debates such as that of the advantages of making technology freely available versus the incentivisation of private gains to spur investment and innovation. The FCA also published a 'Dear CEO' letter on crypto assets and financial crime.

<https://www.fca.org.uk/news/speeches/blockchain-considering-risks-consumers-and-competition>

<https://www.fca.org.uk/publication/correspondence/dear-ceo-letter-cryptoassets-financial-crime.pdf>

Important information for asset managers: CEO of FCA gives speech on regulatory asset management addressing the findings of the FCA's market study

The CEO of the FCA, Andrew Bailey, gave a speech at the London Business School Annual Asset Management Conference on the regulatory side of asset management.

Bailey submitted that one of the most important structural shifts post-financial crisis had been away from the intermediation of financial activity on bank balance sheets towards the non-bank sector and particularly asset management. He goes on to suggest that so far, the markets have adjusted well to the 'gradual turn' in monetary policy that some countries have experienced – and that in principle asset management and other investment funds should act as a shock absorber if there is a snapback in yields, with losses distributed across the system and therefore many investors able to survive the shock and maintain their position long term. Two areas highlighted as those with potential to go wrong, and thus specifically receiving FCA attention, are open-ended funds and exchange traded funds.

<https://www.fca.org.uk/news/speeches/asset-management-regulatory-perspective>

<https://www.fca.org.uk/publication/documents/asset-management-market-study-remedies-overview.pdf>

<https://www.fca.org.uk/publication/market-studies/ms15-2-3.pdf>

Important information for all firms: FCA's Director of Strategy and Competition delivers speech on competition and innovation

Christopher Woolard's speech centred around the unique role of the FCA as a regulator with a competition objective and highlights the difference between 'competition' and 'competitiveness', with the latter not forming part of the FCA's remit. Furthermore, the objective has a specific operational perspective focusing on the promotion of effective competition in the interests of consumers.

Woolard acknowledged the importance of creative tension to drive innovation. Woolard noted the need for innovation to boost competition, and that in reality, these things don't always happen on their own - sometimes the invisible hand of the market 'needs a helping hand'.

The FCA is looking for fintech products that serve a genuine consumer need and believe utility should be the primary driver of innovation.

<https://www.fca.org.uk/news/speeches/helping-hand-invisible-hand-fcas-approach-competition-and-innovation>

Important information for all firms: FCA publish PS 18/10 on retiring guidance relating to inducements and conflicts of interest

The FCA have issued a policy statement on retiring its finalised guidance relating to inducements and conflicts of interest (FG14/1) and independent and restricted advice (FG12/15). Changes to the FCA's rules have superseded most of the guidance, including those which came into force because of MiFID II. The new rules can be found in Chapter 6.2B of the Conduct of Business sourcebook.

FG 14/1 provided guidance to firms relating to compliance with the inducement rules derived from MiFID I. FG12/15 stated that independent advice must be unbiased and unrestricted and based on a comprehensive and fair analysis of the relevant market.

The effect of the changes under MiFID II is to further restrict the ability of retail advice firms to accept any benefits whether monetary or non-monetary in connection with their business of advising, other than certain minor nonmonetary benefits meeting various conditions. Both FG14/1 and FG 12/15 have been retired by the FCA with immediate effect.

The FCA's new rules for inducements and the description of advice services came into effect on 3 January 2018. Firms should, therefore, already be complying with those requirements.

<https://www.fca.org.uk/publication/policy/ps18-10.pdf>

Important information for all MiFID firms: ESMA publishes final report on guidelines for suitability requirements under MiFID II.

The European Securities and Markets Authority ("ESMA") recently published its final report on Guidelines on certain aspects of the MiFID II suitability requirements. The Final Report analyses, and summarises, the responses to the Consultation Paper and explains how the responses have been taken into account. The assessment of suitability is one of the most important requirements for any investor protection within the MiFID framework. The report applies to the provision of any type of investment advice, independent or not, and portfolio management.

The Guidelines:

- consider technological developments of the advisory market notably the increasing use of automated or semi-automated systems for the provision of investment advice or portfolio management (robo-advice);
- build on NCAs' supervisory experience on the application of suitability requirements (including the 2012 guidelines);
- take into account the outcome of studies in the area of behavioral finance; and
- provide additional details on some aspects that were already covered under the 2012 guidelines.

Furthermore, the European Commission published its Action Plan on sustainable finance, in which the EC stated that "firms should ask about their clients' preferences (such as environmental, social and governance factors) and take them into account when assessing the range of financial instruments and insurance products to be recommended, i.e. in the product selection process and suitability assessment."

ESMA has included a good practice for firms addressing the relevant issues, and the good practice will contribute to raising firms' and supervisors' attention and awareness of these issues.

<https://www.esma.europa.eu/press-news/esma-news/esma-publishes-final-guidelines-mifid-ii-suitability-requirements>

Important information for all firms: Official Journal of the EU publishes the Fifth Money Laundering Directive (MLD5)

On 19 June 2018, the text of the Fifth Money Laundering Directive (MLD5) was published in the Official Journal of the EU (OJ). The Council of the EU adopted the Directive on 14 May 2018, following adoption by the European Parliament on 19 April 2018. The Directive will enter into force on 9 July 2018 (that is, 20 days after publication in the OJ).

The main changes to the MLD4 are:

1. Improving transparency on the ownership of companies and trusts via enhanced access to beneficial ownership registers.
2. Better connection of the beneficial ownership registers in order to facilitate cooperation between member states.
3. Lifting the anonymity on electronic money products, such as prepaid cards where the threshold for identifying the holder will reduce from €250 to €150 and there will be an extension in verification requirements.
4. Extending Anti-Money Laundering and Counter Terrorism Financing rules to cover virtual currencies, tax related services, works of art. Also, virtual currency exchange platforms and custodian wallet providers will now need to apply customer due diligence controls.
5. Improving checks on riskier third country transactions, including additional due diligence by banks on financial flows from non-EU countries.
6. Enhancing the powers of EU Financial Intelligence Units and facilitating their cooperation: FIUs are to have access to information in centralised bank and payment account registers so they can identify account holders..
7. Enhancing cooperation between financial supervisory authorities.

Member States have until 10 January 2020 to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive.

https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.156.01.0043.01.ENG&toc=OJ:L:2018:156:TOC

Important information for all firms: FCA acknowledges competition issues in the investment platform market and proposes action

The investment market platform has almost doubled in size in the past 5 years, with £500bn of assets under management and an extra 2.2 million customer accounts opened over the same period. Although the FCA's market study into investment platforms showed that competition is working well for most consumers, the FCA did identify five groups of consumers at risk:

- 1) Those who could benefit from switching but find it difficult or costly to do so – FCA found significant barriers to switching, thus placing a limit on the pressure on platforms to competitively provide continued value for money.
- 2) Those using direct-to-consumer platforms (D2C) who want to choose on the basis of price – FCA found that fees were difficult to understand and therefore hard to compare.
- 3) Those using model portfolios as similar risk labels mean that customers may have the wrong idea about the likely risk/returns they face – FCA found the information the platforms provided made comparison difficult and that investors were left exposed.
- 4) Those with large cash balances – FCA found they may not be aware of the investment returns they are missing out on or the interest they have foregone.
- 5) Those considered ‘orphan clients’ – FCA found they has limited ability to access and alter their investments so were effectively paying for functionality they were unable to use.

The FCA’s proposed package of remedies included measures to help strengthen the extent to which platforms drive competition between asset managers, measures to improve the ease with which investors and advisors can switch platforms, tackling the price discrimination between orphan and existing clients and measures to alert customers holding large cash balances.

<https://www.fca.org.uk/news/press-releases/fca-proposes-actions-improve-competition-investment-platform-market>

Important information for all firms: FCA publishes their Annual Report and Accounts 2017/18

The Annual Report and Accounts looks back on the key pieces of work undertaken by the organisation throughout 2017/18. The highlights from this year include:

- Preparation for Brexit
- The Second Payment Directive (PSD2) and MiFID II
- Senior Management and Certification Regime
- Work on high cost credit and consumer debt
- Campaign alerting PPI customers of complaints deadline

Andrew Bailey, Chief Executive of the FCA identified the three key areas as work done in preparation for the UK’s withdrawal from the EU; regulatory changes; and ensuring that firms treat consumers fairly.

The FCA’s Annual Public Meeting will be held on 11 September at the Queen Elizabeth Conference Centre in London.

<https://www.fca.org.uk/news/press-releases/fca-publishes-annual-report-and-accounts-2017-18>

Important information for all firms: FCA publishes speech on their approach to Brexit

The FCA has been steadily building up their International Division in order to drive forward policy and deliver the work required after Brexit – planning takes into consideration a range of scenarios including the prospect of ‘no deal’ and a ‘hard Brexit’.

The speech delivered by Nausicaa Delfas, the Executive Director of International, acknowledged the general belief of the FCA that a good outcome was possible and that ‘our markets will remain highly integrated whatever the outcome of Brexit’.

The FCA is currently acting under the assumption that running from March 2019 to December 2020 there will be a transition/implementation period to allow more time for the industry to prepare.

‘Cliff edge’ risks were discussed as a possible result of the abrupt loss of passporting, with £26 trillion worth of derivatives contracts currently facing potential consequences. Furthermore, 10 million UK policy holders and 38 million EEA policy holders risk claims on their policy not being paid out.

The speech made it clear that ensuring continuity of the legal and regulatory framework is a key priority of the FCA in this preparation, shown by actions such as the EU Withdrawal Act and the Temporary Permissions Regime – which will allow EEA firms and funds using a UK passport to continue to operate without needing to immediately apply for FCA authorisation after the UK’s withdrawal. Then these firms will be given what are being described as ‘landing slots’ to make their authorisation application in order to undertake business in the UK. It was noted that the EU has made no indication of any intention to create a reciprocal TPR from their side.

The FCA believes it has been clear about the types of arrangement that it believes are possible in relation to the financial services sector, focusing on the five principles of cross border market access; consistent global standards to support global markets; co-operation between regulatory authorities; influence over standards; and opportunity to recruit and maintain a skilled workforce.

<https://www.fca.org.uk/news/speeches/fca-approach-brexit-our-preparations-and-our-vision-future>

Important information for Asset Management and Alternative Investment firms:

FCA sends out Market Abuse systems and controls questionnaire

The FCA has been contacting a sample of Asset Management and Alternative Investment firms to complete a questionnaire regarding the firm’s Market Abuse systems and controls. This exercise is part of the FCA’s thematic work on Market Abuse in investment managers.

It is a post-implementation review of how firms have adapted their approach to the Market Abuse Regulation (‘MAR’) which came into force on 3 July 2016. This follows the last thematic review that was undertaken in 2015 (<https://www.fca.org.uk/publication/thematic-reviews/tr15-01.pdf>).

The responses to the questionnaire will be analysed by the FCA Asset Management Department, part of the FCA’s Supervision Division. Firms will not receive individual feedback on their responses.

However, depending on the outcome of the FCA's analysis, the FCA may following up with further questions, undertake desk-based reviews and/or carry out supervisory visits.

MAR regime overview

The MAR prohibits behaviours such as insider dealing, unlawful disclosure of inside information and market manipulation. Broadly, it applies to financial instruments admitted to trading on a regulated market, a multilateral trading facility (MTF) or an organised trading facility (OTF).

Next steps

- If you receive an email from the FCA to take part in this Market Abuse questionnaire, please do get in touch to discuss how best to respond.
- Prepare for the thematic review by assessing the adequacy of your market abuse systems and controls against the standards expected by the FCA. This should focus on areas such as:
 - Market abuse policy and procedures;
 - Staff training to ensure awareness of the market abuse regime and issues;
 - Pre-trade controls to reduce the risk of market manipulation and insider dealing;
 - Post-trade surveillance to monitor and investigate potentially suspicious trades; and
 - Applicability of the Suspicious Transaction and Order Reports ('STOR') regime.
- Document a Market Abuse Risk Assessment which sets out your firm's market abuse risks areas and any controls in place to mitigate such risks. Our templates can be readily tailored to your firm; please advise if you would like us to help with preparing this risk assessment.

If you have any questions or comments, please do not hesitate to contact us.

Important information for all firms: FCA's Director of Enforcement and Market Oversight discusses MiFID II and the fight against financial crime

On 3rd July 2018, Mark Steward the Director of Enforcement and Market Oversight for the FCA delivered a speech discussing Legal Entity Identifiers, statistics for the initial months of MiFID II and investigations regarding the Money Laundering Regulations.

- Legal Entity Identifiers (LEIs) are a requirement before firms can trade on behalf of their client – the LEI is a unique code and means that every legal entity or structure whom, is party to a financial transaction can be identified regardless of location.
- The FCA now has around 13,000 LEIs and over 2.3 million national identifiers forming part of the MiFID II framework.
- Since the commencement of MiFID II on 3 January 2018 there have been nearly 3.5 billion transaction reports, averaging over half a billion reports per month.

- There are now 23 entities submitting transactions to the FCA, submitting data on behalf of 3,150 executing firms of which 1,500 are UK firms subject to the MiFIR transaction reporting obligations.

The reports being received allowed a more detailed, complex and clearer picture of the market, and are being shared via the European Securities and Markets Authority Transaction Reporting Exchange Mechanism (TREM) in line with the G20/FSB objective of 'a global governance framework representing the public interest'.

Steward acknowledges that 'the framework fosters collaboration across the EU, both now and after Brexit, and encourages local action in attacking global problems'.

There are several ongoing investigations dealing with capital market transactions that appear to have no apparent market purpose or function, as well some investigations into firms' systems and controls whereby the FCA have indicated to the firms being looked at whether there has been any misconduct at a level warranting criminal prosecution under the Money Laundering Regulations.

In the speech, Steward warns that 'systems and controls will not work unless those systems inculcate the ability to ask the right question in a timely way, to be sceptical, to intuit and to stimulate both the ability and desire to detect'.

<https://www.fca.org.uk/news/speeches/mifid-ii-and-fight-against-financial-crime>