



# NEWGATE NEWS

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UP TO DATE COMPLIANCE NEWS FOR  
FIRMS IN THE FINANCIAL SERVICES SECTOR

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## March 2017 - Issue Highlights

- Firms continue to fail to meet FCA expectations on their use of dealing commission
- **Investment managers are still failing to ensure effective oversight of best execution**
- FCA reviews effectiveness of UK primary capital markets
- **EMIR Variation Margin Regulations**
- Changes to the Regulated Activities Order
- **Policy Development update**



## Important for Investment Firms: Firms continue to fail to meet FCA expectations on their use of dealing commission

The FCA have summarised their findings from a review that analysed dealing commission expenditure across a range of investment managers between 2012 and 2015.

The majority of firms that were visited are still falling short of what is expected. Improvement is needed on how firms:

- assess whether a research good or service received is substantive;
- attribute a price or cost to substantive research if they receive it in return for dealing commission; and
- record their assessments to demonstrate they are meeting COBS requirements and are not spending more of their customers' money than necessary

To add, some firms continued to use dealing commission to purchase non-permissible items, such as corporate access and market data services, contrary to FCA rules.

The review looked at a firm's practices including paying for research (some of the firms sampled covered the cost of externally produced research themselves), research budgets, record keeping to demonstrate only substantive research is paid for using dealing commission and avoiding conflicts of interest.

Given these findings and the implementation of changes in MiFID II, Newgate will soon be in contact with firms about how best to comply with the use of dealing commission rules.

<https://www.fca.org.uk/news/news-stories/firms-continue-fail-meet-our-expectations-use-dealing-commission>

## Important for Investment Firms: Investment managers are still failing to ensure effective oversight of best execution

The FCA have outlined findings from supervisory work looking at how investment managers deliver best execution for their clients, concluding that most firms had failed to take on board the findings from the 2014 thematic review and lacked a cohesive strategy for improving client outcomes.

The FCA's concerns include:

- poor use of management information on equity execution costs resulting in 'box ticking' exercises; and
- compliance staff not being empowered by senior management to effectively challenge execution quality.

Despite that, some positives were observed where best execution was considered throughout the entire investment decision making process, and not just by the dealing desk. Firms showing good practice had an effective governance process in place that challenged the overall costs of execution, renegotiated commissions and identified trends that helped improve future execution, which fed into a high level trading strategy.

The FCA will be revisiting best execution in 2017 to see what steps investment management firms have taken to assess gaps in their approach to achieving best execution and how they can evidence that funds and client portfolios are not paying too much for execution. MiFID II places a specific obligation on firms to check the fairness of prices proposed to clients when executing orders or taking decisions to deal in OTC products and firms need to improve current practices for these types of trades.

<https://www.fca.org.uk/news/news-stories/investment-managers-still-failing-ensure-effective-oversight-best-execution>

## Important for Investment Firms: FCA reviews effectiveness of UK primary capital markets

The FCA have published a Discussion Paper which seeks feedback on how the UK primary capital markets can most effectively meet the needs of issuers and investors. The UK's primary capital markets support the wider economy by bringing together investors seeking investment opportunities, and issuers wanting to access capital to finance their businesses.

In particular, the FCA are interested in:

- The appropriateness of the boundary between the standard and premium listing categories
- The effectiveness of UK primary equity markets in providing capital for growth
- Whether there is a role for a UK primary debt multilateral trading facility, and its potential structure
- Measures that could be introduced to support greater retail participation in debt markets

In addition, the FCA also launched a consultation on proposed technical enhancements to the Listing Rules. The proposed changes include clarifying the eligibility requirements for premium listings and updating how premium listed issuers may classify transactions.

<https://www.fca.org.uk/news/press-releases/fca-reviews-effectiveness-uk-primary-capital-markets>

## Important for Investment Firms: FCA proposes reforms to UK equity Initial Public Offerings process

The FCA have produced a consultation paper proposing to reform the availability of information during the UK equity IPO process with the aim of increasing transparency for potential investors.

The consultation paper follows a previous discussion paper published in April 2016 which found that the timing, sequencing, and quality of information being provided to market participants needed improving. Currently, the prospectus is made available very late in the process.

The paper includes a series of proposals which seek to ensure that a prospectus or registration document is published, and providers of 'unconnected research' have access to the issuer's management, before any connected research is released. Ultimately, the FCA wants to see an IPO process:

- with enhanced standards of conduct during the production and distribution of connected research;
- where a prospectus document plays a more central role; and
- where the necessary conditions exist for the emergence of unconnected IPO research.

This consultation is related to the wider work being carried out to increase the efficiency and effectiveness of primary markets (see item above).

<https://www.fca.org.uk/news/press-releases/fca-proposes-reforms-availability-information-uk-equity-ipo-process>

## Important for Asset Managers and Brokerage Firms: EMIR Variation Margin Regulations

The Joint Committee of the European Supervisory Authorities (ESAs) and the International Organisation of Securities Commissions (IOSCO) have responded to industry requests in regards to the difficulty in meeting the deadline of the 1st March 2017 for exchanging variation margin.

The 1 March 2017 deadline is part of a globally agreed framework, which aims at ensuring safer derivatives markets by limiting the counterparty risk from derivatives trading partners. Some market participants have been exchanging variation margin on a regular basis for some time. However, some firms, including, in particular, smaller financial firms, buy-side firms, asset managers, pension funds, and insurance companies, may not yet have well-developed infrastructures to calculate and exchange margin by 1 March 2017.

Due to such difficulties, the ESAs expect competent authorities to generally apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation. The FCA has welcomed this approach. Please get in contact with your Newgate consultant if you require further information.

<https://www.fca.org.uk/news/news-stories/fca-statement-emir-1-march-2017-variation-margin-deadline>

## Important for all firms: FCA consultation on the treatment of politically exposed persons (PEPs) under the Money Laundering Regulations

The FCA are consulting on new guidance for how financial services firms should treat customers who are politically exposed persons (PEPs) when meeting their anti-money laundering obligations.

Currently, firms are expected to take a proportionate approach to meeting their money laundering obligations but there has been some evidence that firms are not applying the correct measures in line with the risk posed by the PEP.

The proposed guidance clarifies who should be considered a PEP, a family member of a PEP or known close associates and the steps that firms should take when dealing with higher or lower risk PEPs.

<https://www.fca.org.uk/publications/consultation-papers/gc17-2-treatment-politically-exposed-persons-peps-money-laundering>

## Important for Fund Managers: Regulatory approach to open-ended funds investing in illiquid assets

The FCA are seeking stakeholder views on the practice of investing in illiquid assets through open-ended funds and the challenges that it can pose to managers and investors.

Investing in illiquid assets provides investors with a number of benefits such as the potential to earn strong investment returns in the medium to long term and diversification of portfolio risk. But open-ended funds that invest in illiquid assets can encounter difficulties if investors expect to be able to withdraw their money at short notice. For example, it can be difficult for a manager to calculate the price of a fund every day if that fund invests in illiquid assets whose prices are calculated less frequently than every day.

The FCA are looking to gather more evidence to decide whether changes to the regulatory approach are needed to enhance market stability and promote competition in the sector, while protecting consumers. Some of the suggestions outlined include a cap on the amount of illiquid assets held in a fund and enhanced disclosure requirements to ensure that investors are aware of the risks associated with a fund investing in illiquid assets.

The FCA invites comments by 8 May 2017.

<https://www.fca.org.uk/news/press-releases/fca-opens-discussion-regulatory-approach-open-ended-funds-investing-illiquid>

## Important for firms with advisory permissions: Changes to the Regulated Activities Order

From 3 January 2018, the requirements for advising on investments will change following an amendment to the Regulated Activities Order. The amendment means that most regulated firms will be exempt from the need to hold a permission to advise on investments under Article 53(1) unless the firm is providing a personal recommendation.

This exemption is designed to reduce the risks of firms carrying on a regulated activity without the right permission, giving them more confidence to provide consumers with information to make their own financial decisions. The FCA have clarified that:

- regulated firms that want to provide a personal recommendation to a client will continue to need permission to provide a personal recommendation; and
- unregulated persons (i.e. individuals and firms which are not authorised by the FCA) are still not permitted to provide regulated advice without authorisation.

There is no need for firms to take any action now. Firms will not have to re-apply for existing permissions for advising on investments or agreeing to do so.

<https://www.fca.org.uk/firms/financial-advice-market-review-famr/changes-regulated-activities-order>

## Important for all firms: Policy Development Update

Each month the FCA issues a Policy Development Update (PDU) which provides information on:

- publications issued since the last edition;
- information about recent Handbook-related and other developments;
- other publications – consumer publications, guidance consultations and finalised guidance; and
- an updated timetable for forthcoming publications.

A link to the latest PDU is here: <https://www.fca.org.uk/news/policy-development-update>