NEWGATE COMPLIANCE

Newgate News

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New normal, new priorities

After working from home for five months the Newgate Team have returned to the office. There has been plenty to catch up on in all areas.

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In this Newgate Newsletter, our Managing Director Matthew Hazell ("**MH**") sits with one of our Senior Consultants, Joe French ("**JF**"), to talk COVID-19, what compliance in the "new normal" may look like and the next important piece of work - the FCA's discussion paper on the implementation of revised prudential regime for investment firms ("DP20/2").

MH: Well, it's been five months Joe and it is certainly good to see you back in the office. How did you find working from home?

JF: It was BAU from day one to be fair. Our structure and systems have always provided us flexibility and we just carried on as usual. We prepared well as it became clear lockdown was approaching, so everyone knew what was required of them. My only regret is not buying Zoom Shares in February. I've never used an app so much!

MH: Indeed, and speaking with clients Newgate is not alone here, with the vast majority finding the ease of remote communications to be one of the very few positives to take from such a turbulent time. The days of large open planned offices may be consigned to history. This obviously has positives and negatives….

JF: Well the new normal brings us, as with most things, opportunities and risks. We will most likely achieve a far better work life balance if working from home becomes the norm for example, however we may miss that regular face-to-face social interaction, whether that's with friends, colleagues or clients. Work wise for us, compliance does not go away and, as we will talk about shortly, the FCA missives come thick and fast. We need to think about what areas of our work need to be improved as we adapt to the new normal.

MH: Give us an example….

JF: Well, take market conduct. For a number of years now the FCA has been hammering a message that it is committed to making the UK a hard place to commit market abuse and financial crime. It has ramped up its own enforcement and surveillance capabilities to detect market abuse and certainly expects firms to do the same. Now in a working from home environment we need to be careful not to slip into an "out of sight, out of mind" situation. We need to be thinking about increased transaction monitoring and whether we should be increasing communication monitoring. If we are seeing less and less use of recorded telephone lines, are we challenging on this and increasing our review of electronic communications? Are we reviewing our automated and non-automated controls in response to the heightened risk? These are all things the FCA will be expecting and will without doubt reviewing in the near future.

MH: In terms of the future, the team for now anyway, is trialling coming back in to the office. How have you found the first week back at Newgate Towers?

JF: Well, aside from the early start, tiring commute and dearth of open cafes and pubs in the vicinity of the office it has actually been good to get back to some normality. It's been great to see the team, although I'm not sure they all feel the same way!

MH: Well quite…It does seem as if most of our clients have taken the opportunity to take a well earned break in August before attacking the rest of the year with renewed vigour. I understand you have been taking the opportunity to catch up on the FCA's DP20/2 discussion paper and webinar on the new prudential regime the regulator is proposing for MiFID investment firms. What are your initial thoughts?

JF: Yes, the team and I have all been digesting the paper and have listened to the helpful webinar. Aside from the content being dryer than a packet of well-known crackers, there looks to be some winners and losers in this.

MH: Would you care to deliver the good news first? Which of our clients are likely to benefit most from the proposed regime?

JF: Our assessment is that it will be our standard BIPRU firms, asset managers and introducing brokers, who should be able to fall into the category of what will be called Small and Non-Interconnected investment firms (SNIs), who will benefit the most. Whilst their initial capital will rise from the sterling equivalent of €50k to €75k, the more onerous requirements that rolled over from banking regulation that related to remuneration and public disclosure requirements will be deleted from the handbook. They will still be subject to a fixed overheads requirement, will have a liquid asset requirement equating to one third of their fixed overheads and will still have to do a risk based capital assessment (although the acronym will change from ICAAP to ICARA). There are some subtle changes between the ICAAP and ICARA processes and we await further guidance from the FCA on this.

MH: In your sage like opinion who appears to be the losers in all this?

JF: To me it looks like in the worst case it will be those firms currently classed as 'matched principal brokers' and to a slightly lesser extent it will be those firms currently classed as 'exempt CAD'.

MH: What is the impact on matched principal brokers?

JF: It looks like they will no longer be subject to a limited prudential regime and will be treated in the same manner as firms that deal on their own account without restriction (i.e. 'dealing as principal'). They will fall outside the definition of an SNI firm and will be subject to the full rigours of the new regime. This will include a minimum capital requirement of €750k, staggered over the next 5 years, as well as the need to calculate the relevant FCA new K-Factors. They will also be in scope for public disclosure and remuneration code principles.

MH: That's quite a jump.

JF: And a little out of kilter with the high level view that the regime has been designed not to radically change the total amount of own funds being held overall, but to better align standards with the business model and source of harm. The advice to our matched principal firms is to read, digest and feed back to the FCA their views on this. We are talking about a "discussion paper" here and the FCA want to hear their views.

MH: What about the impact on exempt CAD firms?

JF: In short, their minimum capital will increase from €50k to €75k, again this will be staggered over a 5-year period. They will also be required to calculate a fixed overheads requirement for the first time, hold liquid assets equal to one month of fixed overheads and be required to document an ICARA. This is basically a progression from requirements the FCA set out to all firms in its FG20/1 paper on assessing adequate financial resources.

MH: What is the impact on firms holding client money or assets?

JF: Minimum capital will rise from the sterling equivalent of €125k to €150k over the next 5 years and such firms will be subject to the more onerous parts of the regime like the firms who deal on their own account. These firms are likely to move out of the regulation under EU CRR and directly into the FCA's new regime and a revised regulatory reporting schedule that this brings.

MH: And what about our fund managers caught by AIFMD?

JF: Well obviously if you don't hold permissions to carry out MiFID activities you are safe, however as we know some AIFMs hold additional permissions and are referred to as Collective Portfolio Management Investment Firms or CPMIs. For CPMIs, you are still classed as an SNI, unless your assets under management are in excess of €1.2 billion.

MH: So, what communications will you be having with clients to bring them up to speed on this regime?

JF: The team will shortly be contacting clients individually to give a short analysis of the impact on them as driven by their prudential category.

MH: So, you and team will be busy for what's lefts of 2020. Any other plans?

JF: Just to get through it and hope 2021 treats us all a lot better!

Newgate will keep you appraised on developments regarding DP20/2 and how it impacts you based on your firm's prudential category and can particularly assist with:

- ***Documenting an assessment of the key risks to your business and the governance and controls to manage the risks or otherwise the financial resources required to cover the risk;***
- ***Producing financial projections to cover a forward-looking three-year period and the plausible but severe stress tests of those figures;***
- ***Assessment of costs and steps required to support an orderly wind down of the business;***
- ***Documenting the governance, risk and compliance framework over the adequacy of financial resources and a summary of the capital a firm has assessed as adequate against the risks run.***

Please contact your Newgate Consultant on 0203 696 8750 if you need assistance on any matters raised in this newsletter.