

"Integrity is doing the right thing, even when no one is watching."

C.S. Lewis

Culture of regulated institutions is driven from the top. It is consistent therefore that where Senior Management lack integrity that the FCA is seen to act and we note that this month the FCA has banned a former chairman of a bank for a lack of fitness and propriety. The FCA is of the view that he failed in his duty to lead by example and to meet the high standards of integrity and probity demanded by the role of chairman.

Transforming culture in financial services

The FCA published a new discussion paper on "Transforming Culture in Financial Services". It has consistently focused on culture and the drivers for changing poor culture in a number of its business plans and publications.

The FCA has, repeatedly cited poor culture as the root cause of some of the major conduct failings that have occurred within the industry in recent history.

In its introductory remarks, the FCA focuses on assessing four main drivers of culture:

1. a firm's purpose;
2. leadership;
3. approach to rewarding and managing people and;
4. governance arrangements.

The FCA and the contributors to the discussion paper agree that there is no "one size fits all" for culture and different firms will be culturally different.

Andrew Bailey, Chief Executive of the FCA, has since delivered a speech on this topic. Key highlights included:

- Work on firm culture is embedded in the work of our supervisors and is an important priority for the FCA.
- Essays in the discussion paper on transforming culture in financial services indicate that culture is about encouraging and incentivising good things and not just stopping the bad things from happening.
- The Senior Managers Regime and measures to govern the payment of remuneration are important developments in creating incentives for good culture.

If you have not reviewed your culture, it is recommended that you do so. This is an area where FMConsult can provide assistance.

FCA update on LEIs under MiFID II

The FCA recently updated its webpage for firms subject to transaction reporting obligations under MiFID II and MiFIR. It refers to a statement issued by ESMA in December 2017 and explains that the approach described requires the FCA to amend the LEI validation rule in the market data processor (MDP).

The FCA had confirmed that no change would be possible before 3rd January 2018. It has now confirmed that the amendment to the LEI validation will be implemented in the MDP on 10th March 2018 and that from **12th March 2018** firms should (re)submit any outstanding transaction reports where the trade date precedes the LEI registration date.

Getting affordability right in consumer credit

Jonathan Davidson, Director of Supervision – Retail and Authorisations at the FCA, delivered a speech on getting affordability right in consumer credit at the Credit Summit in London.

Key highlights included:

- A firm whose business model is predicated on selling products to customers who cannot afford to repay them is not acceptable, nor is it a sustainable long-term strategy.
- The financial situation for some is precarious, which means firms not only need to consider whether a customer has a history of repaying, but whether they are likely to be able to do so in the future.
- A successful business model relies on having a healthy firm culture.

AIFMD Pre-Marketing Clarity proposed

The European Union has published proposed legislation that aims to harmonise the definition of "marketing" across Europe. The proposed changes to the definition of "marketing" will reduce the uncertainty that managers face working out exactly when they are "marketing" and need to register their funds.

The European Commission has recognised that AIFMs face divergent treatment of pre-marketing activities in different national legal systems. Determining where the boundary lies between marketing (which requires a passport) and pre-marketing (which does not) can be difficult to determine. The Commission therefore, proposed a definition of "pre-marketing".

The recitals to the proposed legislation state that in order for an AIFM to be pre-marketing a fund (i.e. prior to requiring the passport):

- a. investors must be unable to subscribe to the units or shares of an AIF because the fund does not exist yet; and
- b. no offering documents, even in a draft form, are permitted to be distributed to potential investors during this stage.

Pre-marketing does not occur if an AIFM provides:

- a. information on an AIF that has been established; or
- b. (where the AIF has not been established) information that amounts to draft or final form prospectuses, constitutional documents, subscription forms, offering documents or other similar documents.

FCA introduce changes to Defined Benefit Pension transfer advice rules

The FCA has announced this month changes to the rules on making transfers from Defined Benefit Pension schemes to Defined Contribution schemes. Some of these come into play on **1st April 2018**.

These changes are designed to remind advisers of the seriousness of any such changes and to ensure that fully qualified specialists vet all proposed transfers independently of the seller.

The FCA is seriously concerned that a re-run of the 1990s mis-selling scandal is possible, as the transfer values from some schemes make transfers lucrative work for financial advisers.

The starting assumption is that any transfer is unsuitable unless proven otherwise. This is to reflect the high proportion of unsuitable advice seen in supervisory work, and follows some recent issues with transfers from the British Steel scheme, whereby the sellers claimed that the customers were not being directly charged for advice.

In line with the FCA's new rules, any transfer must be as a result of a personal recommendation based on the suitability for that individual.

No recommendation can be made unless signed off by a Pension Transfer Specialist, whose role is to independently check and approve the suitability. Previously, it was possible that the seller and specialist were the same person.

The FCA are also launching a new consultation, to look at further changes, especially in the charging structures used to pay for pension transfer advice, and to further increase the qualifications needed to sign off such business.

FCA sets out its Approach to Supervision and Enforcement

The FCA has published its Approach to Supervision and Approach to Enforcement. These documents articulate how the FCA carries out its main activities, aiming to provide transparency to its thought process and decision-making.

The Approach to Supervision shows how the FCA aims to be more forward-looking and pre-emptive in its supervision of firms. Firms' strategies and cultures are at the root cause of most major failings. Supervision's proactive engagement with firms will focus on business models and the drivers of behaviour in firms.

How the FCA supervises

Meeting threshold conditions: When the FCA authorises a firm, it assesses whether it meets the Threshold Conditions.

Making decisions: The FCA has a decision-making framework which guides how they identify and mitigate the risk of harm.

Step 1. Identification of harm through the use of business model analysis and the assessment of the drivers of culture.

Step 2. The use of diagnostic tools. The FCA uses a broad range of expertise in its diagnostic work including day-to-day supervision undertaken by sector-dedicated supervisors.

Step 3. The use of remedy tools. The FCA has four main objectives when using remedies: (i) to stop actual harm as quickly and proportionately as possible; (ii) to ensure firms have put things right (including redressing customers affected); (iii) to address the root causes of potential harm; and (iv) to hold the firm and/or individuals in the firm to account as appropriate where there has been misconduct (this could involve enforcement action).

Step 4. Evaluation. The FCA regularly evaluates its supervisory activities. This consists of both firm evaluation and portfolio evaluation.

The Approach to Enforcement outlines how the FCA conducts investigations and its powers. It also shows how enforcement sets out to achieve fair and just outcomes in response to misconduct and to ensure FCA rules and requirements are obeyed.

Post Brexit Passporting

The FCA has released a statement to remind firms of changes that will occur after **30th March 2019**, when the UK leaves the EU under Article 50. Whilst still a point of negotiation, the EU have ruled out any continuation of the current passporting and marketing rights for UK firms into the EU, but a lesser arrangement remains possible.

The main point of interest is that any firms wishing to passport into the EU/EEA will be able to continue to do so until the end of the transition period on 31.12.20. It recommends that firms liaise with the regulators in the states they are passporting into so they have a contingency plan for January 2021 onwards.

Assessment of the suitability of members of the management body and key function holders.

The European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) have jointly issued Guidelines on the assessment of the suitability of members of the management body and key function holders.

These Guidelines provide:

- common criteria to assess the individual and collective knowledge, skills and experience of members of the management body as well as the good reputation, honesty and integrity and independence of mind of members of the management body;
- set a framework for assessing the time commitment expected of members of the management body and specify how the number of directorships has to be counted, in the case of significant institutions; and
- determine how diversity is to be taken into account in the selection process for members of the management body.

Induction and training are key to ensure the initial and on-going suitability of members of the management body.

ESMA introduces product intervention measures targeting CFDs and binary option products.

The European Securities and Markets Authority (ESMA) has announced new temporary product intervention measures which prohibit the marketing, distribution and sale of binary options to retail clients and restrict the marketing, distribution and sale of contracts for differences (CFDs), including rolling spot forex and financial spread bets, to retail investors. The CFD measures include:

- the introduction of leverage limits on the opening position by a retail client between 30:1 to 2:1;
- a 50 per cent margin close out rule applied on a per account basis;
- negative balance protection, limiting retail clients' liability to the funds in their CFD trading account;
- a prohibition on incentives offered to trade CFDs (excluding research and information tools); and
- a requirement to provide a standardised risk warning.

Following publication in the Official Journal of the European Union firms will have one month to implement the prohibition on binary options and two months to implement the CFD measures.

The FCA has issued a statement supporting the temporary product intervention measures. The FCA expects to consult on whether to apply these measures on a permanent basis to firms offering CFDs and binary options to retail clients. The FCA has issued a Dear CEO letter to some firms asking Matched Principal Brokers to consider the need for Full scope permissions in light of these changes.

Home office circular on Criminal Finances Act and the regulated sector

The Criminal Finances Act 2017 (CFA) introduces new sections into the Proceeds of Crime Act 2002 and the Terrorism Act 2000.

Section 10 of the CFA amends the provisions in POCA that apply where an entity in the regulated sector has reported a suspicion of money laundering and has sought consent from a Nominated Officer, Constable or a Customs Officer to carry out a particular transaction. Where that consent is refused, the entity is currently prohibited from carrying out the transaction for a period of 31 days known as the moratorium period. It also introduces a new power for a senior officer to apply to the court for an order extending the moratorium period.

Section 11 of the CFA also introduces a new procedure in POCA for entities within the regulated sector to share information relating to a suspicion that a person is engaged in money laundering, for the purpose of developing a joint disclosure report to the National Crime Agency (NCA). Section 36 introduces a similar procedure into TACT.

Section 12 of the Act introduces a power for NCA to apply to the court for an order requiring the respondent to provide further information relating to a disclosure made under Part 7 of POCA. Section 37 introduces a similar power into TACT.

The CFA amends the Data Protection Act 1998 to introduce new conditions for processing personal and sensitive personal data, thus steps will need to be taken to ensure that any disclosure complies with both the DPA 1998 and the General Data Protection Regulation (GDPR), which is to come into force in **May 2018**.

Regulating innovation: a global enterprise

Christopher Woolard, Executive Director of Strategy and Competition at the FCA, gave a speech at Innovate Finance 2018 in London. Mr Woolard covered topics including:

- the FCA's collaboration with international colleagues as part of its Fintech story since the launch of Project Innovate in 2014;
- the FCA's regulatory sandbox, where innovation can be tested with consumers, and its role in supporting firms in reducing the time and cost of getting innovative ideas to market;
- the FCA's work with partners from around the world to consider options for a global sandbox in response to demand from firms to operate internationally; and
- the potential of such projects in solving global problems such as money laundering and reducing the regulatory burden of compliance.

ESMA updates EMIR validation rules

ESMA recently published an updated version of its validation rules for the reports submitted under the revised technical standards on reporting under Article 9 of EMIR.

In a related press release, ESMA explains that it has updated the validation rules to:

- allow for the reporting of exchange-traded derivatives in products for which the effective date may be earlier than the date of execution and;
- clarify how the identification of the product should be validated in the reports submitted on or after 3 January 2018.

ESA's report on use of big data by financial institutions

The Joint Committee of the European Supervisory Authorities (ESAs) published its final report on big data, analysing its impact on consumers and financial firms.

The report concludes that big data brings many benefits for the financial industry and consumers, such as more tailored products and services, improved fraud analytics, and enhanced efficiency of organisational internal procedures.

However, financial services consumers should be made particularly aware of some of the risks posed by big data. The risks identified by the ESAs include the potential for errors in big data tools, which may lead to incorrect decisions being taken by financial service providers. Additionally, the increasing level of segmentation of customers, enabled by big data, may have the potential to influence the access and availability of certain financial services or products.

The ESAs have concluded that any legislative intervention at this point would be premature, considering that the existing legislation should mitigate many of the risks identified.

FCA Enforcement cases

FCA fines and bans trader for improperly influencing LIBOR

The FCA has fined the former bank trader £180,000 and banned him from performing any function in relation to any regulated financial activity.

The defendant formerly worked as a short-term interest rate derivatives trader, trading products referenced to CHF (Swiss Franc) and JPY (Japanese Yen) LIBOR.

The FCA found that between 25 July 2008 and 11 March 2010, he made requests to the bank's CHF LIBOR Submitters to adjust their submissions to benefit his Trading Positions; took his own trading positions into account when acting as the bank's primary JPY LIBOR submitter; and improperly agreed with a trader at another LIBOR panel bank to make JPY LIBOR submissions which took into account that trader's requests.

Mark Steward, Director of Enforcement and Market Oversight at the FCA said that his:

"misconduct threatened the integrity of important benchmarks. He should have no further role in the financial services industry."

Accordingly, the FCA has determined that he is not a fit and proper person to perform any regulated financial activity.

FCA bans former chairman of bank

The FCA found that the former bank chair's conduct demonstrated a lack of fitness and propriety required to work in financial services.

They found that while Chair he:

- used his work mobile telephone to make a number of inappropriate telephone calls to a premium rate chat line in breach of the bank's policies; and
- used his work email account to send and receive sexually explicit and otherwise inappropriate messages, and to discuss illegal drugs, in breach of the bank's policies despite having been previously warned about his earlier misconduct.

Mark Steward said:

"The role of Chair occupies a unique place of trust and influence. The Chair is pivotal in setting expectations of a company's culture, values and behaviours." "He failed in his duty to lead by example and to meet the high standards of integrity and probity demanded by the role."

FMConsult Services

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- Company authorisation services
- Fund authorisation services
- Outsourced MLRO services
- Outsourced compliance solutions
- Regulatory project assistance (e.g. Investment Restrictions, Money Laundering, Client Money, ICAAPs)
- Compliance 'Health' checks
- Policy and procedures
- Systems and Controls
- GDPR assistance
- SMCR assistance

UK and Ireland

- Consumer Credit Authorisation, whether you have an interim authorisation or not
- Investment & Operational Risk management services
- Fund restructuring services
- ICAAP review and development
- ACD / Management Company structuring and governance review
- Fund and firm re-domiciliation advice
- AIFM Authorisation
- AIFM monitoring (including risk services)
- Dublin also provides Fund UCITS IV Reporting, MLRO and Company Secretarial Services.

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