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"By failing to prepare, you are preparing to fail."

-Benjamin Franklin.

The FCA issued a note during August warning firms that here are only four months to go until the implementation of SMCR. Alongside this firms will see that the first SMCR Gabriel report has been loaded to their reporting timetable with a reporting period starting from 1 September 2019.

FCA Feedback on Senior Management and Certification Regime (SMCR) implementation.

The FCA has carried out a limited sample of Banks to ascertain how SMCR was operating three years after implementation.

They hope that what they found will be useful to those solo firms who will come within scope of the regime in December this year. It is suggested that firms implementing their regime should consider this note. Key factors include:

- Most firms could not demonstrate the effectiveness of their assessment approach, use of subjective judgement or how they ensure consistency across the population.
- It was not clear that firms are using the Certification Regime to evaluate if managers of certification staff (who are themselves certified) are competent managers.
- The majority of respondents felt that the industry had some way to go to improve the quality and timeliness of regulatory references.
- Firms are not always consistent in recording breaches of the Conduct Rules.
- Firms have not always sufficiently tailored their conduct rules training to staff job roles; FCA reiterated that suitable training was a requirement under FSMA.
- Many firms were often unable to explain what a conduct breach looked like in the context of their business.
- Many firms described a stronger tone and ownership from the top – with a creation of a culture of challenge, escalation and a safe environment for staff to speak up.
- Firms have found it challenging to find appropriate ways of measuring culture and the effort to do so is continuing.
- SMCR is primarily enabling firms to improve their controls environment, which firms expect to lead to improved behaviours. It is not clear to what extent the regime has been linked to culture/culture change.

As a result of this paper the FCA will increase their supervisory focus on the conduct rules. They expect all SMCR firms to ensure that they are embedding the conduct rules in their businesses to meet their obligations under the regime.

With time running out, if you have not started your SMCR project and need assistance, please contact FMConsult.

FCA Checklist for SMCR: Core Firms

If you are still working through SMCR the FCA have tried to assist – here is their non-exhaustive checklist of things core firms should be doing:

I. Identify:

1. Who will be a Senior Manager (SM) at your firm.
2. Whether you need to change any existing approvals, or add new ones, ahead of conversion
3. Whether you firm has a Chair.
4. If so, determine whether they are Executive or Non-Executive.

II. Make sure that you:

1. Understand what you need to do, and which forms are required, to amend your approvals where appropriate.
2. Know which of your current Approved Persons will no longer be approved.
3. Ensure that each of your firm's SMs has a Statement of Responsibilities (SOR).
4. Ensure all the Prescribed Responsibilities applicable to your firm have been allocated to the relevant SM and clearly included in their SORs
5. That if you have an Approved Persons Regime application in progress that FCA haven't processed before SMCR begins, that you submit a SOR within the required timeframe.
6. Identify which of the Certification Functions apply to your firm.
7. Identify the individuals within your firm that need to be certified on an annual basis.
8. Ensure that the annual fitness and propriety checks for Certification staff and SMs fit into your firm's existing HR and other processes.
9. Assess how the new Criminal Records Checks (CRC) and Regulatory Reference requirements fit into your firm's existing recruitment processes.
10. Ensure that your firm has in place the appropriate processes to obtain CRC for new SMs.
11. Ensure that your firms has the appropriate processes to obtain and provide regulatory references.
12. Identify your firm's ancillary staff (i.e. those to whom the Conduct Rules do not apply)
13. Understand the Conduct Rules training and reporting requirements for SMs and all other staff.
14. Consider how staff will be made aware and trained so that they understand how the conduct rules apply in their roles.

Finally the FCA sent out an email this month reminding firms that there are only 4 months to go. In this email they confirmed that if one of your Non-Executive Directors (CF2) performs the role of Chair of your governing body, they must convert to SMF 9 (Chair) by submitting a conversion notification (Form K). Form K will be available from 9 September 2019 via Connect.

FMConsult have been helping clients with their projects, understanding which regime applies to them (Enhance, Core or Limited) and can provide assistance in understanding how to practically approach these issues.

Crypto Assets and the FCA.

In its July 2019 Guidance, The FCA Guidance provided useful clarity on cryptoasset regulation as the cryptoasset market develops and regulators focus on this fast-growing business.

The Guidance is designed to enable market participants to understand whether certain cryptoassets are within the regulatory perimeter or fall outside regulation, and consequently to determine whether they need to be authorised by the FCA and what rules or regulations apply to their business. An activity relating to cryptoassets which does fall within the regulatory perimeter will usually require the firm performing that activity from the UK by way of a business to be regulated by the FCA. **Conducting regulated activities without authorisation is a criminal offence unless an exemption applies.**

The FCA recognises three broad categories of cryptoassets: e-money, security and unregulated tokens, and appreciates that they may move between categories during their lifecycle.

Unregulated tokens are those tokens that do not provide rights or obligations akin to specified investments (like shares, debt securities and e-money). Any token that is not a security token, or an e-money token is an unregulated token.

Utility tokens provide consumers with access to a current or prospective service or product and often grant rights similar to pre-payment vouchers. These are likely to be outside the scope of regulation.

Exchange tokens such as Bitcoin are used as a means of exchange, but they are not currently recognised as legal tender in the UK. Therefore , the transferring, buying and selling of exchange tokens, including the commercial operation of cryptoasset exchanges for exchange tokens, are activities not currently regulated by the FCA. However Firms should note that the European Union (EU) Fifth Anti-Money Laundering Directive which is implemented in the UK in January 2020 introduces anti-money requirements to certain cryptoasset activities.

Security tokens are those tokens that provide rights and obligations akin to specified investments, and are likely to be regulated by the FCA, subject to assessment of their criteria. **Firms should also be aware that financial promotions relating to specified assets are regulated unless certain exemptions apply.**

E-money tokens are those that meet the definition of e-money under the UK Electronic Money Regulations 2011 (the EMRs). Firms issuing e-money must ensure they are appropriately FCA authorised or registered.

Tokens can be used to facilitate regulated payment services. The UK Payment Services Regulations 2017 (PSRs) specify regulated payment services which include services relating to the operation of payment accounts, therefore tokens used in this way may mean that the firm operating such services needs to be regulated.

The FCA noted that some tokens could be considered a unit in a collective investment scheme, a debt security, e-money or another type of specified investment. It might also fall outside of the FCA's remit. Ultimately, this can only be determined on a case-by-case basis

FCA Podcast: Culture and SMCR

The FCA posted a podcast: Interview with Jonathan Davidson (JD) FCA Executive Director of Supervision, Retail and Authorisations) and Jayne-Anne Gadhia on Culture and SMCR. There are some interesting take-aways:

1. Root causes of harm in financial services – business models/strategies; and Culture.
2. Healthy Culture = Firms are Purposeful (not just about the money; and Psychological safety (beyond a speaking up culture – the listening culture).
3. Leaders should act as leaders and not just decision makers.
4. Code of conduct codify what is good behaviour as business people, professional people and human beings.
5. Where people are properly empowered and accountable, the culture's healthier.
6. Not just culture in terms of intent, it's also culture in terms of competence, things that cause harm are when people don't know how to do the right thing even though they want to do it.
7. The Conduct Rules are not there to catch people out, they're to give people the courage to say 'I need to call this out' and coming back to the 'we want a culture of safety' – you should be safe to call it out, I think you should be safe to call it out to the FCA.
8. Be the change you want to see in the world'
9. Speaking up should be encouraged and this regime fits in to FCA efforts on increasing diversity and safety including non-financial misconduct such as bullying, harassment, sexual harassment etc.

FCA Insight: Speaking up: small steps to big changes

In their latest INSIGHT edition issued to firm's the FCA looked at some cultural issues, and challenged firms to assess the ability of their employees to speak up. The FCA suggested 4 questions that firms should ask its senior managers/ManCo:

1. What do the firm's employees currently find it easy or difficult to speak up about? (the FCA found that employees found it most difficult to speak up about discrimination, bullying and sexual harassment)
2. Who does the firm need to target to change the culture? i.e. is it the employees or the leaders (who do not listen?)
3. How does the firm want its employees to be able to speak up?
4. How will the firm know what it is doing is working?

FCA issue letter to Chair of Remuneration Committee

The FCA issued the letter to Chairs of Level 1 firms following a review on 19th August 2019. The letter highlights their findings and recommendations to these Chairs including:

1. Chairs are responsible for remuneration policies and procedures – these should contribute to a healthy culture and drive right behaviours.
2. Ex-post risk adjustments to remunerations should be consistent and oversight from the chair is expected to make sure this is the case. The FCA has issued Finalised Guidance in this area.
3. Remuneration policies should positively influence the firms approach to diversity and inclusion.

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FCA published Market Watch 60

Market Watch 60, is the FCA's newsletter on market conduct and transaction reporting issues and follows the conviction of a former compliance officer in the London branch of a major investment bank. As reported in last month's newsletter he was found guilty of five counts of insider dealing, as well as of unlawful disclosure of inside information. This edition contains information about the FCA's view on controlling access to inside information, findings of the FCA's Thematic Review of processes controlling information flows, and its key recommendations. In the review they noted:

- failures to restrict access to inside information to those who need it for the proper fulfilment of their role;
- electronic files containing deal-specific information stored in files accessible across the entire team;
- absence of regular reviews of access rights;
- insider lists with insufficient details to demonstrate effective control and tracking of inside information;
- support staff regularly having access to inside information; and
- incomplete audit trails.

Firms need to undertake an assessment of the nature of their businesses, the market abuse risks that may arise as a consequence, and the systems and controls that are most suited to mitigate those risks. In particular, the FCA expects firms to take reasonable steps to ensure that the risks of handling inside information are identified and appropriately mitigated.

All regulated firms are impacted by FCA Policy Statement on Prudential Requirements

The FCA issued a policy statement in June **addressing all firms**. The FCA noted that 18,000 of the 59,000 firms are subject to the prudential standards in the FCA handbook. Although all are required to have sufficient Financial Resources under their Threshold Conditions.

In the paper the FCA set out its reasons for these requirements. Whilst it did not intend necessarily to increase Financial resource requirements their aim intend to improve the way firms operate so that they can prevent harm from occurring, by improving controls and/or reduce the risk in their activities, and can put things right when they go wrong.

It noted that the Financial Services Compensation Scheme (FSCS) paid a total of £846 million in compensation for claims made against FCA solo-regulated firms between 2013 - 2017. However, over 70% of these were for firms not subject to detailed prudential standards. They describe this as being an unfair transference of the burden from failing firms to the rest of the industry; so firms not subject to detailed prudential rules may be likely to be considered against this paper in future FCA visits.

All firms should assess the risks inherent in their business model, the potential harm that can be caused and explain how to close the business in an orderly way.

The FCA set out 5 Key expectations of firms:

1. Firms are required to hold an appropriate level of capital and/or liquid resources to cover potential harm.
2. An adequate risk management and controls framework needs to be supported by effective governance, leadership and a purpose. They should help firms to anticipate problems and prevent them from occurring or rectify problems when they occur.
3. Firms should identify and assess the impact of potential harm, to consumers and markets.
4. Firms should identify, understand, and assess all the material risks which can affect the level of financial resources they have available, not just those which cause direct harm to customers and markets.
5. Understanding a firm's financial vulnerabilities and proximity to failure is important to minimise its impact.
6. Adequate Wind-down planning

Whilst these are standard expectations for the 18,000 firms; if you fall outside these firms these expectations make clear that a proportionate consideration of these factors should be documented.

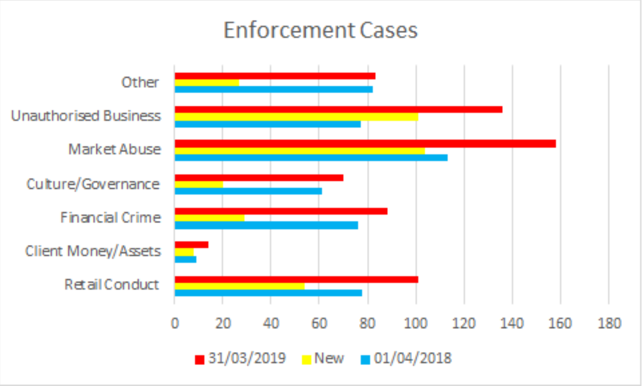
FCA Enforcement Publication

The FCA recently issued its enforcement statistics for their year ended 31/3/19. They continue to enforce their Threshold condition requirements, which has resulted in 226 firms being closed during the year, with over 2141 new cases opened during the year, including 2036 in relation to Consumer Credit firms. Such referrals include:

- lack of adequate resources
- failures to comply with Financial Ombudsman Service awards
- convictions of offences involving fraud and dishonesty
- non-submission of regulatory returns, and
- non-payment of fees

Whilst the number of financial penalties issued remains constant at 16 compared with the previous year, the costs have increased significantly from £69.9m to £227.3m with an even split of cases between firm and individual.

However the overall number of enforcement cases continues to increase with open cases at their year-end totalling 650, compared with 496 cases at the beginning of the period, despite the number of new cases decreasing slightly. As set out below the primary focus on the FCA appears to be on Market Abuse and Unauthorised business activities, but in all cases the number of open cases at the end of the period exceeds that at the beginning:



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Individual and Firm Fined for Client Money Failings

The Financial Reporting Council (FRC) announced on 01 August 2019 sanctions against KPMG Audit Plc and a partner, in relation to their Client Assets Reports in respect of The Bank of New York Mellon London Branch and The Bank of New York Mellon (International) Ltd ("BNY Mellon entities") for 2011.

KPMG and Individual, who, as a director, signed the 2011 Client Assets Reports on behalf of KPMG, had previously admitted misconduct.

The sanctions imposed are:

KPMG:
1. A fine of £5m, discounted by 30% for admissions of misconduct, to £3.5m;
2. A severe reprimand; and
3. A requirement for a quality performance review process affecting each person who signs a Client Assets Report on behalf of KPMG, and a requirement to provide written reports to the FRC on the details, conclusions and actions arising from the reviews.

Individual:
1. A fine of £75,000, discounted by 30% for admissions of Misconduct, to £52,500;
2. A reprimand.

The Tribunal found that "the misconduct consisted of a failure to understand and to apply fundamental rules of CASS, requiring the banks to keep their own records and carry out their asset reconciliations on their own legal entity basis. No dishonesty or recklessness was involved but the Misconduct involved the misapplication of rules that…are of very great importance to the financial system."

The sanctions against the individual reflected KPMG's admission of its failure to provide for him appropriate training and support; that the individual was not a partner at the time of the Misconduct; and that the individual is not presently working as a CASS auditor.

Individual banned from performing any function in a regulated firm

A former Director of a Wealth Management firm was banned from conducting any further functions for any regulated entity or firms that would be regulated other than they were applicable for an exemption.

This ban came despite the individual not being authorised at the time of a conviction under the Criminal Law Act 1970, which also saw him subject to a confiscation order under the Proceeds of Crime Act 2002.

The FCA points doubt that these matters demonstrated that the individual is not a fit and proper person.

Cross-border distribution of collective investment funds: Directive and Regulation published

The Directive and Regulation in relation to the cross-border distribution of collective investment funds have been published in the Official Journal of the European Union.

The legislation intends to make the cross-border distribution of investment funds simpler, quicker and more cost effective by:

- introducing rules on pre-marketing in the EuVECA and EuSEF Regulations – managers will be able to "test the appetite" of potential investors for new investment strategies by engaging in pre-marketing activities;
- introduces new AIFMD pre-marketing rules;
- For UCITS funds sets out new requirements including indicating in marketing that a prospectus and KIID is available, how to obtain; and not be contradictory in the marketing of anything contained in the official documents;

The Directive and Regulation entered into force on 1 August 2019, with the exception of certain provisions. The Directive needs to be transposed into national law by 2 August 2021.

Central Bank of Ireland's Thematic Review on Closet Indexing

The CBI recently sent to a "Dear Chair" letter to Chair person of UCITS Boards relating to their review on closet indexing.

The European Securities and Markets Authority ("ESMA") has described closet indexing as a practice whereby asset managers claim, according to their fund rules and investor information documentation, to manage their funds in an active manner while, in reality, the investments and performance of the fund tracks closely to a benchmark.

In November 2018, Derville Rowland – Director General, Financial Conduct at the Central Bank, speaking at the Irish Funds London Symposium, referred to closet indexing and said, "*It is a key priority for the Central Bank to ensure that investors are not disadvantaged by funds operating in a manner that is not consistent with their disclosure*,"

Their findings highlighted in the letter:

1. Poor governance and controls by boards.
2. Multi-manager UCITS consistently delivering performance similar to an index
3. Past performance section of the KIID did not include relevant benchmark disclosure
4. Insufficient, inaccurate and/or inconsistent disclosures about investment strategy.
5. UCITS have a target outperformance against a benchmark that is less than the fee charges to certain share classes in the UCITS.

The CBI expect Board to address these issues.

Upper Tribunal publishes decision on the former COO of Barclays Wealth

Mark Steward, Executive Director of Enforcement and Market Oversight at the FCA, said: 'Senior management must be held to high standards of integrity which is the fundamental cornerstone of good conduct in trusted markets. The COO failed to act with integrity in one telling instance which is enough to justify this censure.' In March 2012, the COO received a document which contained critical findings about the culture within Barclays Wealth's US branch, Barclays Wealth Americas. Subsequently, the Chairman of Barclays Bank plc (of which Barclays Wealth is a division) received an anonymous email alleging that "a Wealth cultural audit report" had been suppressed. The COO assisted in drafting a response to this allegation.

The substantive hearing took place in January 2018. The Upper Tribunal found that the COO was reckless in giving the impression that the document did not exist. Accordingly, the Upper Tribunal found that the COO's conduct failed to meet the required standard of integrity. The FCA also alleged that the COO made false or misleading statements to his colleagues in a response to the US Federal Reserve Bank of New York in November 2012 about the same document. The Upper Tribunal did not uphold this allegation. The Upper Tribunal also found that, following these events, the COO made a misleading statement to his professional regulator (the Institute of Chartered Accountants in England and Wales) concerning the nature of his conduct. However, the Upper Tribunal did not uphold the separate allegation that the COO had misled the FCA. Following a separate hearing on sanctions in March 2019, the Upper Tribunal determined that the appropriate sanction was for the FCA to publish a statement of the COO's misconduct (a public censure) and did not uphold the FCA's submission that a breach of the obligation to act with integrity by a senior manager merited a prohibition order in this case. The FCA has, accordingly, published a Final Notice.

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