

**"Research is creating new knowledge." Neil Armstrong**

There has been further comment from the FCA regarding what can be paid for using Dealing commission and a lot of questions as to what exactly "substantive Research," is?

Whilst the research Neil was referring to put a man on the moon, the FCA hope to achieve a similar achievement by creating a far more transparent and fair industry for retail clients.

There has also been guidance regarding when personal advice becomes a regulated activity and a significant change to the payday loan industry.

**FCA Thematic review and speech: Dealing commission.**

The FCA gave a speech this month based on its clarified rules on dealing commission and their thematic review published in May. The FCA made it very clear that firms and consumers should only be paying for services directly related to executing a trade or substantive research out of dealing commission.

Dealing commission equates to around £3 Billion a year and is paid for executing trades and external research.

The practice of brokers bundling execution and research services makes it harder for investment managers to assess the value of research. Based on these findings, the FCA announced its support for proposed European reforms to further separate research from dealing commission, to encourage greater competition and more transparency over the price of research.

The FCA stated their engagement with the industry regarding this topic at times has demanded "difficult conversations," and that

*"No industry remains successful without a willingness to evolve with the times – or to deal with difficult debates. And dealing commission...is clearly one of them – with many complex questions...you want the UK asset management industry, alongside regulators, to be helping to shape the conversation, rather than being led by it."*

The FCA feel it would make sense for MiFID II to bring in significant reform across Europe with focus on client services thus allowing asset managers to see this as an opportunity to deliver better transparency, and value for money for customers within the EU, and not look to avoid new rules by preferring other jurisdictions.

The speech ended with a reiteration of the FCA's stance: that investment managers should be operating in the best interests of investors. 70% of delegates at the FCA asset management conference last year said that the current funding model for research does not do this, therefore it is an area that needs addressing.

**FCA – Firms do not understand what is advice**

The FCA has issued Thematic Review guidance for firms that provide simplified advice or sales without a recommendation.

Specifically in regards to firms interested in offering an automated advice service by clarifying when a personal recommendation is given and shared examples to illustrate the point.

The paper gave guidance on the following:

- the current regulatory landscape on personal recommendations in relation to retail investments;
- the results of the thematic work that the FCA have recently carried out examining the new distribution models firms are using to sell investment products to customers in the retail investment market;
- the customer research that the FCA carried out specifically; and
- other examples of where it feels regulated advice was given or not.

**Retail Investment Advice**

The FCA has looked at how personal recommendations are made in the retail market, and have a number of issues. Generally, they feel that most advisers understand when they are straying from the giving of factual information to the giving of advice. What the FCA wants is to move away from a much polarised environment, to one where an adviser has a wider range of options.

The FCA state "regulated advice" must:

- Relate to a specific investment ;
- Be given to the person in their capacity as an investor or potential investor, or in their capacity as agent for an investor or potential investor;
- It must relate to the merits of them buying, selling, subscribing for or underwriting (or exercising rights to acquire, dispose of or underwrite) the investment.

If it does not have all of these characteristics then it is "generic advice" and is not regulated.

The paper gives a new definition for "Execution Only" cases, which differs very little from the accepted current definition. It also goes on to explore the concept of "simplified advice" for use with online and automated sales processes. More FCA guidance will follow.

**AIFMD – Comply now**

The Alternative Investment Fund Managers Directive ("AIFMD") is now fully live, firms managing AIFs without having submitted an application are committing a criminal offence. All firms that have submitted an application must now comply with the AIFMD.

The FCA has published the following forms relating to the AIFMD:

- AIFMD marketing notification;
- AIFMD new fund under management notification;
- AIFMD material change notification;
- AIFMD marketing - letter template;
- Notice of AIFMD delegation;
- Notice of sub-threshold AIFM exceeding AUM limit;
- Small Registered AIFM change form; and
- Notification of senior person amendments or removal.

As at midnight 22 July 2014 the FCA had received 1,130 applications, of which 644 have been approved and a further 129 are ready for imminent approval. The remaining applications are being processed in line with the deadlines laid out in the directive.

### UCITS V adopted

The Council of the EU has announced that it has adopted the UCITS V Directive based on the text it published on 16 July. UCITS V will enter into force on the 20th day following the date of its publication in the Official Journal and Member States will have 18 months to transpose the Directive into national law. Depositories will be given an additional 24-month transition period after the transposition deadline. UCITS V includes rules on remuneration. Those affected by these new rules will see 50% of their variable remuneration paid in fund units and up to 60% of bonus payments deferred for at least three years.

### FCA to Cap Payday Lenders

The FCA has proposed price caps on payday lending. From January 2015, new payday loans, including those which are rolled over, will be subject to a cap on interest rates and fees of 0.8 per cent per day of the amount borrowed, fixed default fees must not exceed £15 and the overall loan cost must not exceed 100 per cent of the amount borrowed.

Martin Wheatley said *"For the many people that struggle to repay their payday loans every year this is a giant leap forward. From January next year, if you borrow £100 for 30 days and pay back on time, you will not pay more than £24 in fees and charges and someone taking the same loan for 14 days will pay no more than £11.20. That's a significant saving...For those who struggle with their repayments, we are ensuring that someone borrowing £100 will never pay back more than £200 in any circumstance."*

The FCA believe this may cost these firms up to £420m based on research where most loans currently charge between 1 and 2 per cent a day.

### Senior Management are liable to FCA action

The FCA is increasingly requiring senior individuals to put their name to compliance guarantees without making it clear their signature will be used against them in the event of enforcement action.

An attestation is a written confirmation that a firm is meeting certain regulatory requirements. They can take the form of a Dear CEO letter and are usually required by the chief executive but can also be required of other individuals holding a significant influence function such as directors or compliance officers.

Usually attestations are used following supervisory action at an individual firm level or where wider market concerns have been established after a thematic review.

The aim is to ensure senior individuals can be held accountable if the problems arise again.

### "Unacceptable" Due Diligence found in Sipp Firms

The FCA has written to chief executives of providers of self-invested personal pensions (Sipps) after their thematic review found 'unacceptable' and 'significant' failings in firms' due diligence around non-standard investments.

A letter to firms from the FCA's director of supervision, Clive Adamson said *"During our review, we found that a significant number of Sipp operators are still failing to manage these risks and ensure consumers are protected appropriately, despite our recent guidance. In our view, the failings we identified put UK consumers' pension savings at considerable risk, particularly from scams and pension fraud."*

The FCA will continue to carry out reviews but has mostly found that operators failed to undertake adequate due diligence on 'high-risk, speculative and non-standard investments despite of being aware of the Financial Services Authority guidance originally published in 2012'.

### Regulatory Update

The FCA continues to assess supervisory Category 4 firms (C4 firms) using a combination of desk-based review, meetings and questionnaires. A meeting might take the form of a preliminary letter (sometimes following a letter or sometimes following a Business risk awareness workshop) asking two managers, including one responsible for managing risk in the firm, to answer questions on its governance and culture, the identification and management of risks including financial controls and reporting.

The message is to have a culture 'to do the right thing', and that includes responding to the FCA's email letter.

The questionnaire is online and requires senior management to spend about an hour and a half completing it page by page (you cannot go backwards to refresh memory of earlier answers which can be awkward since some of the questions are repetitive). The answers are yes or no – there is no room for comments.

Finance training (how often?) and competence figure a lot. At the end there are a series of 'findings' based on the answers. The firm is expected to take action on these although they may not all be relevant to its activities

### MAR – ESMA consults on draft technical standards and advice

The European Securities and Markets Authority (ESMA) has issued two consultation papers on the new Market

Abuse Regulation (MAR). The consultations cover the draft regulatory and implementing technical standards (RTS/ITS) and technical advice which ESMA is developing for the implementation of the MAR framework that will become applicable in July 2016.

The draft technical standards and advice specify the application of MAR to new products, venues and trading techniques and assess transparency and governance issues. They cover areas including:

- market manipulation indicators;
- prevention and detection of market abuse, including suspicious transactions and order reporting;
- accepted market practices; and
- market soundings.

### **The Communications Act 2003 (Disclosure of Information) Order 2014**

The Communications Act 2003 (Disclosure of Information) Order 2014 (SI 2014/1825) came into force on 10 July 2014.

The Order extends the circumstances in which information with respect to a particular business obtained by the Office of Communications in exercise of its functions under the Communications Act 2003 and the Wireless Telegraphy Act 2006 may be disclosed to another public body.

### **Best Execution Polices under regulatory review**

The FCA is currently carrying out a review of firm's best-execution policies. The policies themselves, how firms operate and monitor their effectiveness and how they communicate them to clients

This is both the result of concerns that policies are too general to be meaningful, that firms may have difficulty in finding it when there are so many trading venues and the buy-side does not have enough information to see that they have received best execution with MiFID II with stricter requirements.

### **Enforcement Cases**

#### **Payday lender refunds £700,000**

The Payday lender firm has voluntarily agreed to the refund of interest and default charges to 6,247 customers who, due to a systems error, received a loan amount which exceeded their own lending criteria.

This has come after a FCA review and Clive Adamson, said *"The FCA expects all credit providers to carry out proper checks to ensure that borrowers don't take on more than they can afford to pay back."*

*"We are pleased that [the firm] is working with us to put matters right for its customers and to ensure that these practices are a thing of the past."*

### **Final Notice for Ian Hannam**

The FCA have issued the final notice and confirmed the financial penalty of £450,000.

Mr Hannam engaged in two instances of market abuse by disclosing inside information other than in the proper course of his employment.

The FCA's director of Enforcement and Financial crime, Tracey McDermott, said *"This has been a long and complex case but the Tribunal's substantial judgment is a landmark. It should leave market participants in no doubt that casual and uncontrolled distribution of inside information is not acceptable in today's markets. Controlling the flow of inside information is a key way of preventing market abuse and we would urge all market participants to pay close attention to the judgment."*

### **Bank fined US\$7 billion by US regulators**

The US Justice Department, along with federal and state partners, today announced a \$7 billion settlement with a US Bank. To resolve federal and state civil claims related to the Bank's conduct in the packaging, securitization, marketing, sale and issuance of residential mortgage-backed securities (RMBS) prior to Jan. 1, 2009. The resolution includes a \$4 billion civil penalty – the largest penalty to date under the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). As part of the settlement, the Bank acknowledged it made serious misrepresentations to the public

### **Irish News**

#### **CRD IV and CRR**

The Central Bank has updated its implementation notice on competent authority national discretions and options to reflect the national transposition of the Capital Requirements Directive IV (CRD IV) and Capital Requirements Regulation (CRR), which represent the EU implementation of Basel III.

CRD IV was transposed into Irish national law by the European Union (Capital Requirements) Regulations 2014

As a directly applicable EU regulation, CRR did not require transposition into Irish law but aspects of CRR have been operationalised in Irish law through the European Union (Capital Requirements) Regulations.

UCITS Mancos and AIFMs among others must meet CRD IV requirements on initial capital, own funds and fixed overheads from 1 January 2014.

At EU level, three delegated Regulations on CRD IV Directive regulatory technical standards (RTS) were published in the Official Journal of the European Union (OJ). They come into force twenty days after their publication in the OJ, Five delegated Regulations on CRR RTS were published in the OJ and similarly come into force twenty days after their publication.

#### **Central Bank Markets Update**

On 2 May 2014 the Central Bank published Issue 3 of 2014 of its Markets Update. It covers;

CRD IV transposition/implementation: update for investment firms.

CRD IV: capital conservation buffer and countercyclical capital buffer Regulatory Technical Standards for publication of supplements to the prospectus.

Prospectus Handbook Update (relevant to closed-ended funds) International Financial Sanctions  
Joint Consultation on draft Regulatory Technical Standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP Ninth Edition of the AIFMD Q&A

### ESMA consultation process on MiFID and MiFIR

ESMA launched the consultation process for the implementation of the revised Markets in Financial Instruments Directive (MiFID II) and Regulation (MiFIR).

A Discussion and Consultation Paper have been published based on their requirements to prepare draft regulatory technical standards and advice to the Commission on delegated acts for MiFID II and MiFIR.

The closing date for responses to the consultations is 1 August and any responses should be sent directly to ESMA as per their instructions. Please find the consultations.

### UCITS Q&A Second edition

The Central Bank has released the second edition of its UCITS Q&A which provides the following clarity concerning permitted markets for UCITS and that it will not object if UCITS and AIFs provide for investment of up to 100% of their net assets in securities and instruments issued or guaranteed by the government of the People's Republic of China.

**Q.** Pending the outcome of the Central Bank's consultation on the publication of the UCITS Rulebook (CP 77), will the Central Bank consider the inclusion of additional Regulated Markets in Appendix 1 to Guidance Note 1/96 (Permitted Markets for Retail Collective Investment Schemes)?

**A.** As set out in Consultation Paper CP 77 the Central Bank intends to withdraw Guidance Note 1/96. Pending the issue of a final UCITS Rulebook they are not undertaking to review any submissions in relation to proposed markets. In the interim, UCITS which wish to refer to a regulated market in a prospectus should carry out the appropriate assessments to ensure compliance with the statutory requirements. Regard should continue to be had to the standards referred to in the Guidance Note. The Central Bank may seek sight of such assessments at any time and UCITS should be in a position to explain their decisions in relation to these matters.

**Q.** The UCITS Regulations and the AIF Rulebook provide for investment by UCITS and Retail Investor AIF respectively of up to 100% of their net assets in the securities of certain issuers, details on which are set out in the investment fund application forms. Will this list include securities and instruments issued by the government of the People's Republic of China?

**A.** The Central Bank will not object if UCITS and AIFs provide for investment of up to 100% of their net assets in securities and instruments issued or guaranteed by the government of the People's Republic of China. This position has been reflected in the investment fund application forms

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### FMConsult Contacts:

#### Dallas J. McGillivray

Group Managing Director  
& Authorisation Services  
Tel: 020 7220 9073

[dmcgillivray@fmconsult.co.uk](mailto:dmcgillivray@fmconsult.co.uk)

#### Colette Panebianco

Director FMConsult USA  
[cpanebianco@fmconsult.us](mailto:cpanebianco@fmconsult.us)

#### Andrew (Andy) Hicks

Director, Head of Monitoring Services  
Tel: 020 7220 9074  
[ahicks@fmconsult.co.uk](mailto:ahicks@fmconsult.co.uk)

#### Satrajit Roy

Director FMConsult Arabia  
Tel: +97150 9209315  
[sroy@fmconsult.ae](mailto:sroy@fmconsult.ae)